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HEARINGS

BEFORE THE

SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

GOVERNMENT COMPETITION WITH SMALL BUSINESS

WASHINGTON, D.C.—JUNE 24, 1981
LOS ANGELES, CALIF.—AUGUST 27, 1981
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GOVERNMENT COMPETITION WITH SMALL BUSINESS

WEDNESDAY, JUNE 24, 1981

U.S. SENATE, SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 424, Russell Senate Office Building, Hon. S. I. Hayakawa, chairman of the subcommittee, presiding.

Present: Senator Hayakawa.

Also present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; Kimberly A. Elliott, professional staff member; Alan Chvotkin, chief counsel, minority; Margaret M. Broadbin, hearing clerk; Grace Hussie and H. D. Palmer, Senator Hayakawa's staff.

Senator HAYAKAWA. It is my pleasure to call the Subcommittee on Advocacy and the Future of Small Business to order for these hearings today.

STATEMENT OF HON. S. I. HAYAKAWA, A U.S. SENATOR FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS

Senator HAYAKAWA. The Subcommittee on Advocacy and the Future of Small Business has convened this morning to consider a complex and controversial issue: To what extent does the Federal Government compete with the small business sector?

Over the past few years, I have become increasingly concerned about the growing number of Government intrusions into the private marketplace. Since the business of Government is not to be in business, I ask myself why Federal employees are currently operating over 11,000 commercial or industrial activities that the private sector also performs, often at lower costs. I wonder what has become of our longstanding national policy of reliance on the free enterprise system to provide the commercial goods and services used by the Federal Government.

Small business owners around the country are asking themselves similiar questions. However, to these small businessmen and women, the issue of Government competition represents more than a policy debate on the proper role of Government in a free enterprise system. For them, Government competition is often a matter of economic survival.

In 1979, a concerned group of small business owners began to investigate the extent of Government competition with small, for-profit enterprises. Under the sponsorship of the Small Business Administration's Office of Advocacy, this task group published their findings in a penetrating and constructive report entitled, "Government Competition: A Threat to Small Business." I think many of you are already familiar with this document.

This hearing, which is the first in a series of hearings on Government competition, will focus on the competition report and its recommendations to the Congress.

Today, we are privileged to have as witnesses the chairman of the competition task group and several of his colleagues. These small businessmen not only researched and compiled the comprehensive report on the topic of Government competition with the private sector, but each also has had first-hand business contact with either direct or indirect Government competition. Their experiences illustrate how a successful business can be severely threatened by a Government agency's decision to produce goods or services in-house that currently are being produced in the private marketplace.

A representative of the National Federation of Independent Business will offer testimony and will introduce one of the coauthors of an interesting book entitled, "Better Government at Half the Price."

Also this morning, we will hear from the Administrator of the Office of Federal Procurement Policy and a representative of the General Accounting Office. These Government officials, like small business witnesses, are urging Congress to tackle the problem of Government competition by reaffirming the national policy of Government reliance on the private enterprise system for supply of its needed goods and services.

I responded by introducing a Senate joint resolution that does just that. Without objection, I would like to make the resolution and my floor statement about it part of the hearing record.

[Material follows:]

[S.J. Res. 93, 97th Cong., 1st sess.]

JOINT RESOLUTION To clarify and reaffirm that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

Whereas it is the function of Government to establish Federal policies and manage Federal programs established by or pursuant to law; and

Whereas it is the function of the private enterprise system, which is the primary source of national economic strength, to provide goods and services needed in that endeavor; and,

Whereas optimum efficiency, economy, and productivity can be achieved if the Government relies on competitive procurements from private enterprise for its needed goods and services; and

Whereas in a democratic free enterprise system, the Government should not compete with its citizens: Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That it is the general policy of the Government of the United States to rely on competitive private enterprise to supply the products and services it needs whenever competitive industry prices are available. This policy shall be administered by the Director, Office of Management and Budget in coordination with the Administrator, Office of Federal Procurement Policy.

[From the Congressional Record, Monday, June 22, 1981]

By Mr. HAYAKAWA (for himself, Mr. Hatch and Mr. Nickles): S.J. Res. 93. Joint resolution to clarify that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services; to the Committee on Governmental Affairs.

PRIVATE INDUSTRY TO SUPPLY GOVERNMENT WITH GOODS AND SERVICES

Mr. HAYAKAWA. Mr. President, I introduce today, together with my colleague in the House, David Dreier of California's 35th District, a joint resolution that reaffirms the policy now embodied in the Office of Management and Budget Circular A-76. Senators Orrin Hatch and Don Nickles are originated cosponsors.

The joint resolution states:

It is the policy of the Government of the United States to rely on competitive private industry to supply the products and services it needs whenever competitive industry prices are available.

For some years I have observed the tendency of the Federal Government to assume and retain functions that should be left to the private sector of the economy. Though it has long been the government's policy to rely on the private-sector for goods and services, that policy has not been applied equally throughout all branches of the government.

As a result, Federal employees, according to the GAO's estimates, perform 11,000 commercial or industrial activities that could be done by private firms. Taxpayers pay near $19 billion for these goods and services, and in doing so they directly subsidize competition for private industry.

There are certain government functions that must be performed by the government, such as formulating policy. But I do not believe government resources should be used to duplicate functions that are properly available from the private sector at a lower cost.

This may sound like a philosophical problem, but to the owner of a small business it is a matter of economic survival. Struggling with inflation, interest rates and excessive regulation, the last thing a small business owner needs is competition from the government financed by tax moneys.

Let me give some examples of the government activities that duplicate efforts of the private sector: Printing and binding, data entry and processing, food service, laundry service, audio-visual production, library services, and research.

If the $19 billion spent on such goods and services were channeled into the private sector rather than into government agencies, three important things would happen:

First, the government would get the same services at reduced cost. That is because private enterprise has an incentive government agencies do not have: The profit motive. The Small Business Administration has conservatively estimated that $3 billion of that $19 billion could be saved.

Second, private industry would benefit by increased business that would stimulate the whole economy.

Third, and this is important, government workers and resources would be freed to concentrate on functions that must be performed directly by the government. In this time of increasing demands on government resources, this increased efficiency will help preserve or even increase the level of government service provided to the public.

The General Accounting Office has prepared a report, for release today, that examines the extent of government competition with the private sector. The GAO and the Office of Management and Budget agree that congressional action is needed to establish as a matter of policy throughout the government that private industry should be used to supply goods and services whenever that is practical and proper.

This is not a shift in government policy; it is a clarification of government's relation to private enterprise and a clarification of a policy that has been subject to varied interpretations and shifts in emphasis over the years.

As a further exploration of this issue, on Wednesday, June 24, the Small Business Subcommittee on Advocacy and the Future of Small Business—of which I am chairman—will open a series of hearings examining the effects of government competition on small business. We will examine specific industries in which that competiton is a significant problem, and we will hear from owners of businesses that have been crippled or threatened with extinction by government decisions to provide similar goods and services.

Mr. President, I ask unanimous consent that the text of the joint resolution be printed in the Record.

There being no objection, the joint resolution was ordered to be printed in the Record, as follows:

S.J. RES. 93

Whereas it is the functions of Government to establish Federal policies and manage Federal programs established by or pursuant to law; and

Whereas it is the function of the private enterprise system, which is the primary source of national economic strength, to provide goods and services needed in that endeavor; and

Whereas optimum efficiency, economy, and productivity can be achieved if the Government relies on competitive procurements from private enterprise for its needed goods and services; and

Whereas in a democratic free enterprise system, the Government should not compete with its citizens: Now therefore, be it

Resolved by the Senate and the House of Representatives of the United States of America in Congress assembled, That it is the general policy of the Government of the United States to rely on competitive private enterprise to supply the products and services it needs whenever competitive industry prices are available. This policy shall be administered by the Director, Office of Management and Budget in coordination with the Administrator, Office of Federal Procurement Policy.

Senator **HAYAKAWA**. Again, let me state that the primary purpose of this initial competition hearing is to explore the extent of Government competition with small business. I believe this session will be enlightening and thought provoking. Most importantly, I believe that this and subsequent hearings will allow small business owners the opportunity to fully establish the need for the 97th Congress to enact the competition resolution I have introduced.

The first panel will be made up of Senator Roger Jepsen of Iowa; Mr. Dale Nelson, BMS Services, Des Moines, Iowa; James Hostetler, Chapman, Duff & Paul of Washington, D.C.; Mike Roush, deputy director of legislation, National Federation of Independent Businesses of Washington, D.C., accompanied by Dr. James T. Bennett, author.

Will these witnesses please take seats at the table?

Senator Jepsen.

STATEMENT OF HON. ROGER W. JEPSEN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **JEPSEN**. Mr. Chairman, it is with a great sense of pride, pleasure, and honor that I am here today before the Subcommittee on Advocacy and the Future of Small Business of the Small Business Committee. I thank you for giving me the audience.

It is with a sense of pride because I am a product of small business myself. I grew up on a family farm. I firmly believe in small business, and throughout my public and private life, I have sailed a course straight for the horizon upon which all who succeed in business must chart, namely the horizon of free enterprise.

Mr. Chairman, I am especially pleased today to introduce one of the leading small business advocates in the Nation, my fellow Iowan, Mr. Dale Nelson.

In the world of small business and American success stories, Dale Nelson is not unique. He is a classic example of a private individual who, through the free enterprise system, began a business with $200 and no employees and today, 20 years later, has a company payroll in excess of 500 employees.

Professionally, Dale Nelson is the founder of Building Maintenance Service, BMS, which grew from a one-person janitorial service operation in 1959 to a multimillion dollar diversified business today.

In 1979, Mr. Nelson served as chairman of the Task Force on Government Competition with Small Business in the Small Business Administration's Office of Advocacy. He also served as a member of the White House Conference on Small Business Task

Force on Federal Procurement. He was selected as chief of research for Government procurement for the White House Conference on Small Business in January 1980.

Mr. Chairman, I recommended him to serve on the President's Small Business Advisory Council. I am looking forward to his appointment because he is such a strong, dedicated spokesman for small business.

Mr. Chairman, I want to especially thank you for your efforts in calling this hearing on Government competition. There is no question that one of the major problems facing small business in America today is the fact that the Government competes with small business in almost every aspect of business endeavor.

Mr. Chairman, we must face the fact that Government is in business. It is in business to the detriment of small business and the small business community.

Besides the Government being in business competition with small business, it adds misery to pain by regulating small business out of any meaningful or fair competition with other business interests.

Therefore, Mr. Chairman, I support your efforts here today. Furthermore, I am pleased to join you in sponsoring your Government competition resolution, Senate Joint Resolution 93. It is essential that the Congress and the American people are made aware of the enormous problems involving Government competition with the private enterprise system.

Thank you, Mr. Chairman, for the audience. Again, I repeat it is with a great deal of pride and honor that I introduce Mr. Dale Nelson.

Senator HAYAKAWA. I thank the distinguished Senator from Iowa for his support and interest in this whole subject. I thank him also for his introduction of Mr. Nelson.

Mr. Nelson, you come with the fine credentials of personal experience in this area. It will be a pleasure to hear your testimony, sir.

STATEMENT OF DALE NELSON, PRESIDENT, BMS SERVICES, INC., DES MOINES, IOWA

Mr. NELSON. Thank you, Mr. Chairman.

First, let me thank my Senator, Senator Jepsen, for those kind words.

Mr. Chairman, I would like to take this opportunity to thank you personally for giving us the opportunity to explore something that we have all worked very hard on. That is Government competition, both direct and indirect.

Let me suggest to you, Mr. Chairman, that the task force that I was privileged to chair was really a very historic action because very few small business people have been afforded the opportunity to comprehend the overall nature or the extent of the Government competition issue, much less have an opportunity to participate directly in the developing of a policy on that subject.

This is true all over the Nation, Mr. Chairman, in spite of the fact that the small business community in this country represents 58 percent of the jobs. We represent 43 percent of the gross national product. We represent 92 percent of all R. & D. that took place in the last 10 years.

Between 1969 and 1979—I am not quoting you small business statistics, Mr. Chairman, but I am quoting Government statistics—there were 8.2 million new jobs in this country; 7.1 million of those were created by the very community I sit here today representing.

Government created about 600,000 of those jobs. Big business created about 400,000. No, we are not against big business, but we are sure for small business.

The task force held hearings in Des Moines and Washington, D.C. We heard a total cross section of testimony from the small business community, Federal officers, and the field of academics. Virtually all of these people voiced the opinion that the reliance on the private sector would result in lower prices with as good or better services or goods than are presently being provided by the Government.

Government sets the standards for themselves today, as Senator Jepsen indicated, and, in turn, sets a different set of standards for the small business community. Small business does not want any handouts. We merely want the opportunity to compete in a free marketplace, as I think our Founding Fathers intended. What we uncovered in our hearings is merely the tip of the iceberg.

Mr. Chairman, you are to be congratulated on your perception of the problems faced by small business from Government competition and your desire to improve the current situation.

The joint resolution which you introduced is precisely what is called for to establish congressional direction for complete reliance wherever possible on the private sector.

We trust that through the vigilance and efforts of this subcommittee and others who are sensitive to the damage done to our society through Government competition with small business the Congress of the United States of America will mandate Federal reliance on the private sector for needed goods and services through passage of your proposed joint resolution and other measures identified as necessary in the course of these hearings.

Senator Hayakawa, I thank you very much.

[The prepared statement of Mr. Nelson follows:]

STATEMENT OF

DALE NELSON, PRESIDENT
BMS SERVICES, INC.

before the

SUBCOMMITTEE ON ADVOCACY AND THE
FUTURE OF SMALL BUSINESS
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

on

GOVERNMENT COMPETITION WITH SMALL BUSINESS

June 24, 1981

Mr. Chairman and Members of the Subcommittee, my name is Dale Nelson and I am President of BMS Services, Inc. in Des Moines, Iowa. During 1979 and 1980 I served as Chairman of the Small Business Administration Task Group on Government Competition with Small Business.

With me is James S. Hostetler, a partner in the Washington, D.C. law firm of Chapman, Duff and Paul, who served as chairman of one of the SBA Task Group's subcommittees. We are pleased to have this opportunity to discuss the alarming impact of Government competition upon small business, and to describe the conclusions and recommendations of the SBA Task Group.

Creation of the Task Group

The SBA Chief Counsel for Advocacy created the Task Group on Government Competition in response to growing concerns expressed about Government competition from small business people across the country. It was clear that a need existed for inquiry into the nature and extent of Government competition as it affects small business. In order to properly assess the issue, a group of concerned and informed small business people from all over the country were named to the Task Group.

In a way, this was an historic action. Small business people have been afforded few opportunities to comprehend the overall nature and extent of Government competition,

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let alone participate directly in developing policy on this subject, despite the fact that small businesses provide 43 percent of the gross national product and approximately 54 percent of the nation's jobs. From 1969 to 1979, 8.2 million new jobs were created. Small businesses provided 7.1 million or 87.6 percent of those new jobs. The government provided 600,000 and big business only 400,000 new jobs during this period. In addition, 92 percent of all research and development is performed by small businesses.

The overriding concern of the Task Group was to examine the Government competition issue as objectively as possible through research, public hearings, and a careful analysis of other recent work in the area. The task was made more difficult because little was known about the specific nature of cases involving Government competition with small business. There was no documentation of the effect of government competition on the small business community.

A cursory look at information available at the time of the Task Group's creation led to the conclusion that "Government competition with small business" is a complex and nebulous issue, despite its dramatic impact on small businesses. Examination of this information led to the development of the following general goals to be addressed by the Task Group:

- Determine the nature and extent of direct or indirect Government competition problems, specifically in small business terms (cataloging as many specific cases as possible in the process);

- Identify, examine, and determine the significance of the public policies and institutions that have the greatest influence over matters relating to Government competition with small business;
- Learn what has already been accomplished by earlier studies, hearings, and Executive actions that focused on the competition issues; and
- Develop specific recommendations on how to reduce current levels of Government competition with small business.

With these broad goals in mind, the Group concentrated its attention primarily at the Federal level where information was more easily accessible, although ultimately we learned that the problem may be as serious at the state and local levels.

Work of the Task Group

Over the course of four months following the first Task Group meeting in mid-July, 1979, the Task Group heard testimony from a cross section of small business owners, Federal officials and academicians.

With few exceptions, those who testified provided graphic examples of enterprising small business owners who were threatened by competition from the Government. They were angry, not simply because Government competed with them, even though that fact alone seemed contradictory in a free enterprise system, but also because they believed that Government involvement is inherently unfair competition. Virtually all of the participants voiced the opinion that reliance on the competitive private sector would result in the lowest price and that Government production was not likely to result in the most efficient use of resources. Moreover, Government was found to exclude competition by the private sector in many instances, and furthermore to set one standard for itself and a stricter one for the private competitor in other instances.

The damaging impact of Government competition on all sectors of small business activity was a revelation to most of us. We learned of direct Government competition in manufacturing, fabrication, processing, packaging, research and development, office services, printing and reproduction, automatic data processing, and health services -- in virtually every area of small business commerce in the United States. We learned of indirect Government competition through Federal grants to non-profit organizations and state and local agencies which compete with small business. We learned of how the Government grants subsidies in the form of tax exemptions to non-profit organizations which provide commercial and industrial services in competition with small business.

Thus, the Task Group found small business, with increasing regulatory burdens imposed by Government and increasing pressure from big business competition, facing the added nemesis of Government competition. Small business harbors no complaints about competition where the terms are fair, but when the rules of the game are set on the presumption of bigness, when bigness is an advantage in coping with

Government or market factors, and when, in addition, Government itself enters the marketplace, then being small is hardest, and survival is difficult. Government production of goods and services adds one more major factor to an equation that finds small business at a disadvantage. Competition from Government may be direct or indirect, but the blow is substantial regardless, since almost every dollar in value produced within Government represents a missed opportunity for a small business.

The cost to society, however, is much greater than the cost to small business. Studies by other groups have consistently shown that smaller businesses create more jobs, accomplish greater productivity, and produce more technological innovation than to mid-sized or larger businesses. In real terms, therefore, Government competition that denies opportunities to small business comes with a high price tag. Society is not only denied tax revenues that would flow from taxation of their profits but is also denied the jobs, productivity, and innovation that small businesses offer in disproportionate quantity. Small businesses cannot provide these benefits if they are not given the opportunity to compete.

Two economists who appeared before the Task Group emphasized the economic cost to society from a failure of Government to rely on the private sector. First, they described the fact that Government production of private goods and services seldom takes advantage of efficiencies associated with economies of scale. Accordingly, the costs of Government production of goods and services are generally higher because fixed costs are averaged over smaller output than for private firms, which do not have to confine their output to the needs of a particular bureau or segment of a Governmental agency. Second, Governmental agencies typically have no incentives to lower costs of production. In a capitalist economy, resources are efficiently allocated by the market system, and the price of goods and services will dictate the optimal levels of output. Businessmen seek to minimize their costs in order to sell at a competitive price since failure to do so often results in bankruptcy. Accordingly, workers in the private sector are given bonuses as incentives to meet the general sales and cost goals set by management. Successful and ambitious workers who meet these goals will be compensated whereas their counterparts in the Government are not.

Unfortunately, the taxpayer pays a heavy price for the lack of productivity incentives in Government production of private goods. As an example, the economists documented how taxpayers in Fairfax County, Virginia pay nearly four times more for county-run garbage collections than they would for the same service from private companies. The economists concluded that in many areas of commercial activity, such as fire protection, debt collection, hospital care and ship repair, the private sector out-performs the public sector.

Our study was not and could not have been comprehensive. Everything we learned leads us to conclude that the disturbing examples we encountered and recorded in the March 1980 Report of the Task Group represent only the tip of an iceberg.

Conclusions and Recommendations

The Task Group set forth 46 recommendations in its March 1980 Report. They were directed to the Congress, the Office of Management and Budget/Office of Federal Procurement Policy, specific agencies and agencies in general. I would like to address the first of our recommendations directed to the Congress, which relates to OMB Circular A-76. OMB Circular A-76 states the Federal Government's general policy of reliance on the private sector for goods and services. We, like the General Accounting Office, and, earlier, the Commission on Government Procurement, found legislation, regulations and agency practices that conflict with the stated policies in OMB Circular A-76. This apparently stems from a fundamental lack of consensus by Federal officials on the wisdom or need to rely on the private sector and a general ignorance of Government competition's complexity and broader economic and tax implications.

Since issuance of our Report, the Executive Branch has once again made an effort to obtain agency compliance with OMB Circular A-76. In an April 8, 1981 Memorandum to Heads of Executive Departments and Agencies, the Deputy Director of OMB stated the Administration's strong support of the general policy of reliance on the private sector and the importance of such reliance in maximizing the efficient expenditure of funds. Separate letters were written to several agencies listing functions which should be considered for contracting out.

Despite the good intentions of the new Administration, several decades of experience indicate that OMB Circular A-76 will not be adequately implemented without Congressional direction. The Task Group recommended that the Congress enact a national policy directing that the Federal Government rely to the maximum extent possible on the private sector.

The General Accounting Office report released at the press conference which your subcommittee held on Monday, June 22, reached the same conclusions as the Task Group -- experience under OMB Circular A-76 demonstrates the need for Congressional direction.

Mr. Chairman, you are to be congratulated on your perception of the problems faced by small business from Government competition and your desire to improve the current situation. The joint resolution which you introduced is precisely what is called for to establish Congressional direction for a preference of reliance on the private sector.

Since release of the Task Group Report in March, 1980, concern over fraud and abuse in the award and administration of Federal contracts has further encouraged the building of in-house capacities. Usually, at the root of problems cited as abusive in the acquisition process has been poor or non-existent management by the procuring agency. Increasing Federal production of goods and services is not the answer -- improvement of Federal management and the quality of the procurement workforce is the answer.

We trust that through the vigilance and efforts of this subcommittee and others who are sensitive to the damage done to our society through Government competition with small business, the Congress will mandate Federal reliance on the private sector for needed goods and services through passage of your proposed joint resolution and other measures identified as necessary in the course of these hearings.

Senator HAYAKAWA. Thank you, Mr. Nelson.

STATEMENT OF JAMES S. HOSTETLER, ESQ., CHAPMAN, DUFF & PAUL, WASHINGTON, D.C.

Mr. HOSTETLER. Thank you, Mr. Chairman.

In the interests of time, I would like to request permission for my full statement to be introduced into the record.

I would like simply to make some general comments about the subject of Government competition in support of your resolution, Senate Joint Resolution 93, which affirms that it is the basic policy of the Government to rely on the competitive private enterprise system to provide needed goods and services.

What we have found in the course of hearings last year, Mr. Chairman, was very simply that few subjects distressed small business people more than Government competition. They see both a philosophical and a practical issue.

The philosophical issue was stated simply: What is the proper role of the Government with respect to the production of goods and services?

The practical question was: How can small taxpaying organizations survive and flourish when faced with competition from Government itself and nonprofit instrumentalities which receive special advantages from Government in the competition for Federal dollars and business?

Since the country's founding, a basic tenet of Government has been that the business of Government is not business. We believe that a careful reading of the SBA task group report will establish that this basic principle has received lip service at best and is essentially being observed in the breach.

The fundamental concept of Government reliance on the private sector in acquiring needed goods and services is not based on some hypothetical benefit analysis. It is based on what works and what serves the public interest.

In a major study made in 1972, the President's Commission on Government Procurement stressed that optimal efficiency results from competitive private enterprise, not Government monopolies. The benefits flowing from competitive private enterprise in terms of cost effectiveness, efficiency, innovation, and productivity cannot be emphasized too strongly.

The simple fact is that the failure to mandate by legislation an effective policy of governmental reliance on competitive private enterprise is costing the public billions of dollars in wasted expenditures.

The task group's very conservative estimate based on very partial data was that $3 billion could be saved by mandating a policy of reliance on the private sector. In the course of its research, the task group was staggered by what it learned about the widely diverse sectors of the economy where small business suffers from unfair direct and indirect Government competition.

Among the numerous sectors we discovered serious examples of abuses and unfair competition were retailing, printing, manufacturing, films, audiovisual and media materials, research and development, employment services, travel services, laboratory testing and analytical services, professional services of all kinds, day care centers, camping, and many, many other commercial and industrial activities.

I believe that the report contains six single-spaced pages indicating areas which we investigated. There were many more that time simply did not permit us to investigate.

We found, as Senator Jepsen and Mr. Nelson have said, that the small business person faces a Federal Government which acts in a variety of conflicting roles. The Government collects taxes from the small business person, regulates that person's activities, controls his access to capital and credit through the banking system, to name only a few.

When on top of all of this, the small business person meets Government face to face as a competitor in providing goods and services, he tends to feel pretty strongly that something is wrong. The reason is simply that Government has increasingly assumed the one role that ultimately is intolerable to the small business person. That is, the Government is competing at the same time as the Government is setting the rules that govern the marketplace.

To deal with the problem, the task force recommended as its top priority enactment of legislation mandating a national policy of reliance on the private sector. The joint resolution which you have introduced would meet this fundamental request.

The urgent need for action cannot be overstated. The present OMB circular which deals with reliance on the private sector actually defines private as including State and local government, and nonprofit organizations as well as taxpaying private sector firms.

The task force report describes a number of other deficiencies in present policy. Additionally, in my statement we detail a number of ways in which Congress has taken specific legislative steps to seriously compromise a sound policy of reliance on the private sector.

In concluding, I would like to take just one moment to quote the words of the report:

> Small business harbors no complaints about competition where the terms are fair, but when the rules of the game are set on the presumption of bigness when bigness is an advantage in coping with Government or market factors, and when additionally Government itself enters the marketplace, then being small is hardest and survival is extremely difficult. The cost to society, however is much greater than the cost to small business. Studies by other groups have consistently shown that small businesses create more jobs, accomplish greater productivity, and produce more technological innovation than larger businesses. In real terms, therefore, Government competition that denies opportunities to small business comes with a very high price tag. Society is not only denied tax revenues that would flow from taxation of their profits, but is also denied the jobs, productivity, and innovation that small business offers in disproportionate quantity. Of course, small business cannot provide these benefits if they are not given the opportunity to compete.* * *

Your proposed resolution, Mr. Chairman, represents the solution, or the beginning of the solution, to this problem.

Thank you.

[The prepared statement of Mr. Hostetler follows:]

STATEMENT OF
JAMES S. HOSTETLER
CHAPMAN, DUFF AND PAUL
BEFORE THE
SUBCOMMITTEE ON ADVOCACY
AND THE FUTURE OF SMALL BUSINESS
OF THE
SENATE COMMITTEE ON SMALL BUSINESS
ON
GOVERNMENT COMPETITION WITH SMALL BUSINESS
JUNE 24, 1981

Mr. Chairman and Members of the Subcommittee:

My name is James S. Hostetler and I am a partner in the law firm of Chapman, Duff and Paul in Washington, D.C. I served as a member of the SBA Advocacy Task Group on Government Competition. For a number of years I have represented small businesses and associations of small businesses which have experienced serious problems of unfair commercial competition from the Federal government. My testimony is intended to provide an overview of the nature and scope of the problem of government competition with small businesses and to make specific recommendations of how government can better serve the public interest by meeting national needs in the most effective and economical way.

An Overview

Small businesses are a major source of tax revenues and the major source of new jobs in the United States. As such, they have a vital stake in fair and workable Federal laws and policies to achieve governmental economies and efficiencies by assuring proper reliance on the private sector when the Federal government acquires goods and services. What concerns small businesses and the SBA Task Group which investigated their concerns about "government competition" are the many instances where a governmental unit provides for itself (or others) goods or services that can be better provided by the private taxpaying sector.

Government competition is both direct and indirect. It is direct when government at any level, through in-house government personnel, provides goods and services that are available in the private sector. It is indirect when it takes the form of commercial or enterprise activities by nonprofit or not-for-profit organizations which are unfairly advantaged by Federal grants, tax exemptions, regulatory exceptions and other Federal benefits not available to taxpaying small businesses.

The scope and extent of the problem of government competition is not generally understood. One commentator has summarized the expansion of the government's position in the marketplace for goods and services in this way:

> Nevertheless, the innovations in the forms of government enterprise during the past several decades have been so varied and pervasive that they almost represent a structural transformation. Under the impact of depression, war, cold war, breakthroughs in nuclear power and in the technology of space, together with the intensification of problems precipitated by industrialization and urbanization, government has been brought face to face with new and demanding problems requiring attention and solution. As our history would have foretold, the response has been largely pragmatic. New departures have been made in enterprise forms as well as in their relations to private and nonprofit sectors, in Federal, state and local governments. These innovations have resulted in an erosion of many conventional distinctions between the private enterprise and the governmental sectors; they have led to the establishment of new joint forms of enterprises involving government and business, government and nonprofit organizations, and various levels of government; finally, they have resulted in a great proliferation of special-purpose public authorities or public corporations.[1]

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[1] E. Ginzberg, D. Niestand, B. Reubens, The Pluralistic Economy 34, 35 (1965).

As a consequence of these structural changes in the way enterprise activity is pursued in the United States, it is fundamentally important no longer to defer blindly to the sovereign, particularly when the sovereign over several decades has used its position to gain unfair advantages for itself and the independent nonprofit sector in the marketplace. Federal laws and policies designed to assure that fair rules govern the competition among governmental units, nonprofit organizations and taxpaying small businesses when engaged in providing commercial goods and services are badly needed.

Realization of this fact gave rise to the SBA Task Group. In the course of its research, the Task Group was staggered by what it learned about the widely diverse sectors of the economy where small business suffers from unfair direct and indirect government competition. Among the numerous sectors where we discovered examples of unfair competition were retailing, printing, manufacturing, films, audiovisual and media materials, research and development, employment services, travel services, laboratory testing and analytical services and professional services of all kinds, day-care centers, camping, and many many other commercial and industrial activities. Former Director of the Bureau of the Budget, Rowland R. Hughes, described the gravity of the problem this way:

> The Federal government today...is among other things, the largest electric power producer in the country, the largest insurer, the largest lender and the largest borrower, the largest landlord and the largest tenant, the largest holder of timberland, the largest owner of grain, the largest warehouse operator, the largest shipowner, and the largest truck-fleet operator.
>
> For a country which is the citadel and the world's principal exponent of private enterprise and individual initiative, this is rather an amazing list.

While hard data on the dollar value and number of government commercial activities is difficult to develop, the General Accounting Office's recent report entitled, "Civil Servants and Contract Employees: Who Should Do What for the Federal Government?" (FPCD-81-43), June 19, 1981, conservatively estimates that at least 25 percent of the amount paid to Federal employees in compensation is earned by individuals dedicated to in-house commercial activities that could be performed by the private sector. Authoritative sources estimate that procuring these goods and services from competitive private enterprise should result in average savings of 35 percent over noncompetitive costs.

Since the country's founding, a basic tenet of government has been that the business of government is not business. We believe that a careful reading of the SBA Task Group report will establish that this basic principle has received lip service at best and is essentially being observed in the breach.

This fundamental concept is not based on some hypothetical rationale. It is based on what works and what serves the public interest. In a major study made in 1972, the President's Commission on Government Procurement stressed that optimal efficiency results from competitive private enterprise, not government monopolies. The critical benefits flowing from competitive private enterprise cannot be emphasized too strongly.

To nurture competitive private enterprises requires cooperative, not antagonistic government policies. Unfortunately, the United States government in its relations with the private sector is losing ground to its foreign competitors. West Germany, Japan and other major trade competitors when faced with a requirement begin by examining what capability exists in the private sector and how it can best be utilized. When none exists or the private capability is inadequate, these governments develop a strategy with the private sector to create the needed capability in the private sector.

To show how differently our government behaves, I direct your attention to the case of DSET Laboratories, a leading private solar testing laboratory in the United States, whose capital investments in sophisticated testing equipment have been placed in severe jeopardy because of insensitive Department of Energy and other Federal and state agency policies and actions which have unfairly competed in the extreme. The case is described in the Task Group report on pages 6-9. The problem experienced by DSET with government competition appears to be the norm, not the exception.

The simple fact is the failure to mandate statutorily an effective policy of Federal reliance on competitive private enterprise is costing the public billions of dollars in wasted public expenditures. The proposed joint resolution represents the basic policy mandate which is needed to have better government at less cost.

Need for Specific Legislation

Ostensibly the nation's policy has been and continues to be that the government should rely on the private sector for goods and services. Over a period of years this policy has evolved and changed, however, culminating in OMB Circular A-76, as revised in April 1979, to recognize government as a competitor with private enterprise and establish a methodology which gives the Executive great flexibility to justify in-house activity and recapture activities from the private sector. An excellent analysis of the problems under the present policy Circular is contained in a recent article in the Government Executive on "Contracting Out" which I ask be included in the record of this hearing (Attachment A).

To understand the urgent need for legislative action, it is useful to review some recent Congressional and Executive initiatives to compromise a sound policy of reliance on the private sector.

- Sections 502 and 602 of the fiscal year 1982 defense authorization bill (S. 815 and H.R. 3519) would interfere with recent A-76 policies governing contracting out and conversion of DOD work to private contractors. Edwin Harper, Deputy Director of OMB, in testimony before the House Committee on Government Operations on the DOD Authorization Act of 1982 on June 3, 1981, was sharply critical of piecemeal efforts to legislate away the A-76 policy. I ask that his testimony be included in the record of the hearing (Attachment B). Subsequently, Representative Horton's amendment to delete Section 602 was adopted. It should be noted that Section 502 of the DOD Authorization Act of 1981 made permanent law a provision reflected in the fiscal year 1980 act which placed additional responsibilities on DOD prior to awarding a contract for operation of a commercial or industrial type function.
- Section 304 of H.R. 3519 forbids the use of authorized funds to contract out an entire medical facility. Representative Horton successfully had deleted from the bill this provision when the bill came before the House Government Operations Committee. It is likely that the Senate and House will receive two versions of sections 304, 502, and 602, one surely intended to sabotage A-76.

- Section 10004 of reconciliation bill (H.R. 3964), as reported out by the House Post Office and Civil Service Committee, in dealing with personnel ceilings and contracting out raises new questions about its impact on the A-76 policy.
- The Schroeder amendment to H.R. 3413, the proposed DOE authorization bill for fiscal year 1982, would interfere with an orderly contracting out decision on security services, even though the successful bidder has provided comparable security services at a nuclear weapons assembly facility in Amarillo, Texas, for some 20 years.
- In the waning days of the Carter Administration, the Labor Department issued a regulation implementing the Service Contract Act to apply the prevailing wage requirement to broad classes of professional workers with the likely result of inflating those wages unnecessarily. The Reagan Administration, recognizing the problem, moved quickly to stay the regulation, but the Act and its application remain a serious problem for private contractors working with the Federal government. This is another example of a Federal law which has a chilling impact on doing work Federally. (See Washington Post editorial dated June 6, 1981 -- Attachment C).

- The most subtle attack on contracting out has been the attack on private consultants -- when you read the fine print in proposed legislative and executive controls and limits, you find that they extend to a wide range of professional, research and technical services. No consistent or careful definitions have been advanced as to what is meant by the term consultants or consulting services. Controls and limitations on consultants acting as individual experts who provide personal advice often without preparation of a report have been indiscriminately extended to a wide range of professional services, analytical studies and management support services offered by small business contractors. Careful distinctions which responsible Federal officials try to make to describe different kinds of professional services have been blurred and ignored in the appropriation, authorization and budget reconciliation process.

In its recently released report, GAO has posed a legitimate question: what work represents performance of a governnmental function and what work is legitimate for a contractor to perform? This debate has special significance as the economy requires more and more specialized technical and professional skills. The public interest would be served by improved utilization of private sources of expertise, but the trend is in the opposite direction. This trend runs counter to another fact of contemporary government -- that highly trained and skilled individuals are not easily attracted to work directly for government. In a column in the New York Times on June 20, 1981, James Reston explored this significant development (Attachment D). While an assessment should continue as to how government can recruit the best and eliminate the unnecessary, the national interest requires a renewed affirmation of the need and desirability of utilizing private sector sources of expert technical services and seeking creative ways to encourage and motivate private contractors to work for the government. GAO's broad generalizations about private contractors impinging on the performance of governmental functions needs to be cautiously evaluated in light of the public interest in assembling capabilities wherever they are found to pursue national goals. Confronting private sources of expertise with new limitations, controls and bureaucratic hurdles is designed to aggravate an already bad situation.

Much hinges on the outcome of the debate. In recent testimony of the Office of the Secretary

> of Defense and the Joint Chiefs of Staff for fiscal year 1982 funds for outside research and analyses, the cost of undisciplined attacks on an ill-defined category of contractors labelled "consultants" was sharply calculated (Attachment E). If the national security interests of the nation are to be advanced, more attention needs to be paid to how to mobilize the nation's skilled resources, not build barriers to their effective utilization. Incidentally, over 95 percent of all firms in the professional services, including consultants, are small businesses.

While piecemeal Congressional efforts to legislate exceptions to a policy of reliance on the private sector proliferate, the SBA Task Force report details a number of ways in which the existing laws and policies are deficient. For example, would you believe that the preference for the private sector in the present A-76 defines private sector to include state and local governments and nonprofit organizations? We urge careful attention to the specific recommendations contained in the Task Force report to strengthen the A-76 policy. Your resolution implements the most important recommendation in the Task Group report.

Finally, it is not only crucial to establish a strong legislative basis for a policy of reliance on the private sector in procuring goods and services; it is also imperative to review and reform tax, grant and other laws favoring nonprofit organizations engaged in commercial activities. To cite one example of the problem of indirect competition, in the critical field of applied research, more and more work is being placed with nonprofits who have Federally created advantages over their taxpaying competitors. A recent article in the Wall Street Journal describes the trend (Attachment F).

In the last several years, the media and some Congressional sources have been sharply critical of the government practice of contracting out to the private sector alleging widespread fraud, abuse and waste. Surely no one can deny that there have been instances of each, but to cite cases of impropriety does not justify opposing implementation of a sound national policy of reliance on the private sector. Wasteful contracts must be eliminated, and useful contracts awarded -- by public employees. Specifications for procurements must be approved -- by public employees. Contract proposals must be carefully reviewed and evaluated -- by public employees. Once a contract is awarded, public employees must monitor the work as it is being performed. In short, the way to deal with fraud, waste and abuse is to improve the procurement and management of the work of private contractors by Federal employees, not attack a sound policy of reliance on the private sector. To put this problem in better perspective, GAO in a recent report provides guidance on who commits fraud, "Fraud in Government Programs" (AFMP-81-57), May 7, 1981. GAO selected 5,000 cases of over 77,000 cases of actual or suspected fraud investigated by 21 Federal departments and agencies. Less than 1 percent were found to involve private contractors. In fact, a significant percentage of the fraud was committed by Federal government employees, not businesses or corporate entities. Neither sector can rest easy, however, until the system is improved to produce better goods and services at lower costs and with an absolute minimum of fraud, abuse and waste. Your legislation, Senator, is the place to begin.

Is This Issue Important?

The issue of government competition is particularly critical for small business. The Task Group report says it this way:

> Small business harbors no complaints about competition where the terms are fair, but when the rules of the game are set on the presumption of bigness, when bigness is an advantage in coping with Government or market factors, and when, in addition, Government itself enters the marketplace, then being small is hardest, and survival is difficult... The cost to society, however, is much greater than the cost to small business. Studies by other groups have consistently shown that small businesses create more jobs, accomplish greater productivity, and produce more technological innovation than the mid-sized or larger businesses. In real terms, therefore, Government competition that denies opportunities to small business comes with a high price tag. Society is not only denied tax revenues that would flow from taxation of their profits but is also denied the jobs, productivity, and innovation that small businesses offer in disproportionate quantity. Of course, small business cannot provide these benefits if they are not given the opportunity to compete....

To many small businesses, the income lost from direct and indirect government competition constitutes the difference between success and failure; to their employees, government competition means loss of employment. To the public, government competition means inefficient application of public monies, lower productivity, less innovation and lost tax revenue.

Simple fairness requires action. The inherent competitive advantages government and its favored instrumentalities, the nonprofits, enjoy are substantial.

The Subcommittee is to be commended for giving prompt attention to one of the most basic issues of our times. I would welcome the opportunity to try to answer your questions.

The Administration: Fitting and Sharpening the A-76 Dentures

By Barbara Oganesoff
Associate Editor

HIGHLIGHTS

- *Instead of revising the Carter Administration's stand on A-76, the Reagan people intend to put some teeth into the implementation process.*
- *The real question at issue is the possibility that the Federal Government is in the throes of becoming a big business in direct competition with the private sector.*
- *The obstacles to an effective contracting out policy are the same old ones of bureaucratic empire builders and a cowardly Congress.*
- *And nothing will happen at all unless the top managers in Government get behind the policy.*

The Reagan Administration is not taking any new routes in implementing its policy of reliance on the private sector for commercial and industrial activities. It has, instead, decided to put more teeth into the Carter plan and already there is a resurgence of the controversy which has surrounded the policy for decades.

OMB's current *Circular A-76*, outlines a procedure for the Government to determine the cost effectiveness of performing an activity in-house versus going outside for needed products and services. A cost comparison methodology is outlined in the policy to help agencies make the choice of what is "more efficient and effective for the Government." These comparisons were given great impetus during the Carter Administration and, to some, are the reason for the breakdown in the implementation process (See *Commentary*, this issue, by Burt Hall).

Specifically, the policy asks agencies to inventory their commercial/industrial activities that could be provided by the private sector. These include such things as custodial or guard services, road construction and maintenance, printing and reproduction, laboratory testing and ADP and keypunch services. After conducting a cost comparison, if a 10% savings in personnel costs is recognized, the activity is to be converted to contract.

Those activities that are "Governmental in nature" are exempt from these comparisons. OFPP is presently working on clarifying this definition since agencies are having difficulty here.

According to OMB, there are 11,786 commercial/industrial activities identified in the over $100,000 category (excluding DOD which has 9,244 activities.) The annual operating cost is $1,638,205.00 (for DOD, the cost is $16.9 billion.) In a recent letter from Elmer Staats to OMB Budget Director David Stockman, Staats explains that "this amount represents nearly one-third of the total fiscal year 1981 Executive Branch employee compensation and OFPP and GAO approximate that 400,000 Federal employees will be required to operate these activities.

The frontrunner in implementing the policy is DOD and Joseph Turk, DOD's Director of Maintenance Policy reports that "All of the commercial/industrial activities (CITA) reported in the annual inventory of CITA's will be reviewed within a 5 year period. It is estimated that after identifying activities required for National Defense and those for which no commercial source is available, 15–20% of the activities reviewed will be candidates for cost studies to determine the most economical method of performance. For FY '79 and FY '80, activities involving a little over 12,000 spaces were cost studied resulting in conversion to contract of about 63% of those spaces."

DOD states that approximately 76 cost comparison studies were reported as completed between October 1, 1980 and January 1, 1981, involving 2,300 spaces. About 63% of the studies resulted in decisions to contract-out involving some 1,500 spaces.

They concur with GAO's figure of $130 million savings over the next

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Attachment A

Cost Confused?

While the General Accounting Office (GAO) has taken the position, on numerous occasions, that "make or buy" decisions should be based primarily on cost comparisons (with special care given to the full costing of the in-house alternative), the agency has never addressed the more basic question involved. That is, should the Federal Government, as a matter of principle, challenge the production of in-house goods and/or services that are competitively available from the private sector.

Burt Hall, one time member of the Commission on Government Procurement, is a National Contract Management Assn. Fellow and currently a Group Director with GAO. What follows is Hall's own informed, and provocative, views on this issue.

This country was founded on the principle that private enterprise, not the Federal Government, should conduct business activities.

Unfortunately there has been an increasing trend away from this position. Comparing cost of products or services rendered in-house *vs.* private firms can now be done to justify, and even enlarge, in-house operations. Not only is it bad policy to compete public and private activities but the cost comparison tool itself is flawed. Further, cost comparison is an easy way for our highest policy makers to sidestep taking a position on our private enterprise system—pro or con. It is, in effect, a convenient crutch.

The latest OMB *Circular A-76* Revision has diverted the original purpose to the point that maintaining in-house operations is easier and recapturing activities from the private sector is an acceptable if not encouraged result. The methodology used to justify and maintain this policy shift is *Cost Comparison*. A cost comparison is now required in every case even if the existence of highly competitive private sources makes the result inevitable.

When the cost comparison exception reared its ugly head in the 60's, it had one redeeming feature. The agency decision maker had to determine that the savings advantage in retaining in-house operations outweighed the disadvantage of *not* supporting the private enterprise system. This one saving feature disappeared with the Carter Administration's *A-76* revision.

In an attempt to rationalize the new *A-76* policy, the Carter Administration published an elaborate 90-page handbook to give the cost comparison technique a facade of legitimacy and to overwhelm objections to its validity or ultimate purpose. The disastrous results it could produce have seldom been challenged.

But first, what is the potential use of this new cost comparison tool? In Defense alone there are 15,000 commercial and industrial activities spending $17 billion a year. And the Armed Services Committees have made cost comparisons a matter of law. So Defense cannot, as some agencies are doing, ignore cost comparisons. Almost half the cost comparisons made to date under the new circular favor in-house retention.

When the Federal Government competes against its own citizens (using their money no less) many significant and long lasting detrimental effects are inevitable. Here are some of the more glaring errors and paradoxical results of utilizing the new A-76 guidelines.

- Cost comparisons alone are too narrow for decision-making because a sound business choice must also consider quality, reliability, timely delivery, and flexibility to meet changing demand.
- Cost comparisons themselves are unreliable. Government accounting systems are not designed for business activities and do not enable true cost comparison with private firms. Secondly, there can never be an equal understanding between the ongoing in-house operations and interested private firms about the specific work to be done and the required standards of performance.
- Cost comparisons do not reflect long-term considerations. For example, they penalize the private firm for startup cost although it is a one-time occurrence.
- Cost comparisons do not recognize the absence, on the Government side, of incentives to take risks, innovate, adapt to new technology, and cut costs. There is neither carrot nor stick to motivate in-house activities.
- Cost comparisons ignore the painful fact that each in-house business shrinks the tax base and shifts the tax load to others. Private firms pay various local, State, and Federal taxes; Government entities do not. One supports the tax base; the other burdens it.
- Cost comparisons ignore accountability. If the in-house business activity does not satisfy its captive Government customers or, if it performs at a loss, there is no recourse for the immediate and pain consequences that face the private sector firm.
- Cost comparisons contribute to a longstanding Government/industry adversarial relationship—they tend to exacerbate conflict between Government and its citizens engaged in private enterprise.
- Cost comparisons strain the Government's already damaged credibility. How can the Government claim to favor a private enterprise policy but threaten contractors with frequent in-house cost comparisons? How can the same agency (1) decide to conduct business activities in-house, (2) structure cost comparisons with private firms, and (3) then act as a fair judge of these "paper" competitions?
- Finally, applying the new 90-page cost handbook in all its excruciating detail across all Government agencies plus resolving conflicts, contractor protests, congressional inquiries, GAO reports, etc., represents a serious drain on limited agency resources.

In the long term, Federal in-house business activities, like other monopolies, are not geared to emulate innovative firms in the open marketplace in terms of cost, responsiveness, and product improvement. This fundamental characteristic of private business has helped to sustain this country as a unique economic force. To use a simplistic cost justification tool is short sighted, ultimately destructive and does not make either good sense or cents.

The final misstep by the Carter Administration (the OMB Office of Federal Procurement Policy) was the attempt to balance A-76 politically, that is, to develop implementing procedures pleasing to both private industry and Federal Employee Unions. Attempting to balance them is self deluding. Nonetheless, the result was to give our highest policy makers a crutch. Now, faced with constituent pressure Congressmen do not have to choose between private enterprise and Federal Employee Unions—they can just let the cost comparisons and all those who administer them take the heat.

In the early 70's, Congressional, Executive and private sector members of the Commission on Government Procurement—despite all their differences—reached a consensus in one basic area.

- **That a clear national policy statement was needed in law.**
- **That this policy should state a basic reliance on the private enterprise system wherever reasonable prices are available.**

If the Congress adopted this simple straightforward policy, it would be easy to implement. Each agency's procurement system, or its market-research function, could simply identify business activities transferable to a functioning commercial marketplace. The Commission's "reasonable price" requirement would be satisfied and Federal policy held consistent. Exceptions would be legitimate Government functions (such as printing money) or maintenance of a core capability if the particular product or service is critical to the agency's direct mission performance.

For in-house operations without a functioning commercial marketplace the above analysis would not be automatically to stay in-house. Instead, whenever possible, a viable, competitive market should be developed by the affected agency. The newly developed private capability will, with the many aforementioned benefits, always be preferable to in-house retention. This issue is a key to the overall policy's implementation: it precludes the normal preference for the "status quo", and it requires positive action to overcome common place inertia and develop competitive sources.

With the increasing size of Federal, State, and local government, about one-fifth of the nation's workforce, and thus a large part of the voting public, are now government employees. Because of their number, these Government employees are a political force. Thus there is an urgent need for a stable national policy, embodied in law, which can be constantly referred to in response to pressure groups from both sides and which does not vary from one Administration to the next.

In summary, the current policy to justify cost comparisons of in-house with private business operations: (1) violates a basic tenet upon which our country was founded; (2) uses as its rationale a tool which is itself inaccurate, incomplete, shortsighted and otherwise innocent of value; and (3) produces progressively detrimental economic conditions.

If the Reagan Administration expects to make *real* progress in this field, the Executive and the Congress must get back to basics. To resolve this longstanding problem all they need to do is to establish a clear policy that *simply* and *briefly* states a reliance on the private sector when reasonable prices are available, and establish temporary management teams in the larger agencies to oversee an orderly transition of in-house activities to the private sector.

If savings on past transitions hold up (about 20%), the potential government-wide cost reduction is $6 billion plus a healthy expansion of the tax base and revenues.

three years for those DOD functions converted to contract in FY '79 and FY '80.

The consensus of views from many in industry and Government is that the Government is not standing by its own policy of "reliance on the competitive private sector to supply the products and services needed by the Government" (found on page 93 of the President's Budget Revisions for FY 1982). The real question is "Who is competing with whom?" or "Is the Government in the throes of becoming a big business in competition with the private sector?"

William Russell, former member of the Commission on Government Procurement and former Deputy Assistant at OFPP (responsible for implementation of the Circular) explains that, historically, the policy points to private sector reliance as far back as 1955. "Despite this strong expression of policy and recognition of the importance of private enterprise in maintaining our economic strength, the 1979 revised circular then goes on to provide detailed guidelines for cost competition between agencies and the private sector."

Now Vice-President of Government Relations at RCA's Service Company Division, Russell explains that the dicotomy between Administrations developed as a result of the failure of prior directives to effectively implement the policy. "Although a strong philosophical and economic rationale can be presented for the premise that reliance on competitive contract performance is more economical than use of sole source Government activities, opponents of the policy have contended that direct Government operations are less costly and therefore, in the national interest."

Burt Hall, also a former staff member of the Commission on Federal Procurement and a Group Director with GAO's General Government Division thinks the problems with the policy are compounded by the fact that "for the past 50 years the Congress, several Federal Commissions and various Administrations (Republican and Democrat) have taken widely divergent positions about the extent to which Federal activities should legitimately duplicate or substitute for similar private sector activities." Hall thinks since the issuance of the policy in the 50's, subsequent revisions have weakened it. Among these: cost comparisons (which he says are exceptions to the policy), administrative complexities and burdensome paperwork requirements.

Another view from former Administrator of OFPP Hugh Witt (now Vice President/Government Liaison with United Technology) reiterates this concept, "I naturally was disappointed when the rewritten *A-76* policy was held up a year while the Carter people took their own look at the contracting-out issue. Needless to say I felt vindicated when their version came very close to the one I had issued. This vacillation is typical of the treatment the basic policy has received over the years. It is one reason why very few Government employees feel they have to take *A-76* very seriously."

Edwin Geesey, whose views on management problems are outlined later in the article, thinks the "chaotic administration" of the program is due to the lack of attention to planning the entire three to five year effort covering all commercial and industrial functions. This planning is designed to facilitate optimum productivity and performance, regardless of the comparative outcome. "The resulting fragmentation of services into small or unrelated solicitations very often works against the objectives of productivity enhancements and savings resulting from the economies of scale," he adds.

One of the prevalent problems associated with the implementation of the policy is that "Congress has not yet stepped up to the problem," explains Burt Hall. In agreement is Russell Richardson, of the Committee on Contracting Out (a coalition whose sole intent is contracting out the Federal requirements for goods and services). To Richardson, who voices his independent views on the improper application of the policy, Congress is "the single most critical obstacle."

"For years it has evaded or thrown back attempts by various Administrations to curtail or eliminate inefficient and costly functions. Despite Congressional bromides offered to rationalize these actions, the fact remains that our legislature operates as a tight fraternal organization. Federal procurement actions have wide political implications both real and perceived. Too many decisions are made for the benefit of local constituencies on the basis of 'I'll vote to protect the Federal jobs at your Base 'X' because I know you'll remember it when I need Federal funds for a dam in my State or district.'"

What Richardson points out is that Congressional circles love to cry "waste and fraud" and hang their claims on the Government procurement process implying that the crooks come from the private sector. "The truth is that you rarely have a bad contract or misconduct between the Government and a contractor without the involvement of misconduct, bad judgement, inadequate control or other elements on the part of the responsible Government employees, procurement specialists and monitors. Yet it remains popular in Congress to criticize the mechanisms and extol the virtues of legislative solutions." He calls it "legislative erosion" or Congress' fundamental ambivalence with respect to supporting corrective actions needed to give the policy teeth. To Richardson, discipline, not rules, are needed.

Government Unions' Clout

Russell Richardson fears that 1981 is already showing signs of "a further rash of those legislative initiatives which promise utopian solutions, but too often mask an intention to maintain the status quo, or worse, in deference to the strong political pressures applied by the Federal employees and their unions" and he hopes the Republican mood may indicate "an intolerance to the use of Federal procurements as pawns on political chessboards."

Burt Hall lists five reasons why executive agencies and policymakers are biased toward continuing and/or expanding in-house activities: (1) all the people involved in the activity in question are deciding whether it should continue (2) to justify their existence and enhance appreciation, the Government employees have long fostered a distrust of private sector willingness or capability to produce at a reasonable price (3) substantial, wide ranging power bases are filled with people who naturally want to keep their positions or influence (4) action entailing confrontation and considerable effort is hardly preferable to tranquility and leaving things as they are and finally (5) Congressional considerations of this issue have suffered from giving undue attention to the self-serving arguments of labor unions and other special interest groups favoring in-house activities under the guise of Federal worker welfare.

Russell Richardson cites an industry study, based on Government published data for the years 1965 through 1976 in which Federal purchases for goods and services as a percent of the total Federal budget dropped from 53% in 1965 to 34% in 1976—a reduction of 19%. During this same period the Federal workforce remained stable or flourished.

His concern is for the taxpayer who, he says has been badly served over the past several decades. "It is evident when the 19% reduction is factored by the billions of dollars involved and the lack of real competition, the impregnable job security of Federal employees, and the built-in inability of Government to generate motivation approaching that of the profit and loss statements of industry" he adds.

Edwin Geesey thinks the problem the agencies are having implementing the policy stems from a lack of dedication by top management and a lack of commitment by operational managers to "fair play." Geesey is Director of Industrial and Facilities Programs at Advanced Technology, Inc. (a large professional services and engineering firm which supports commercial and industrial activity review programs under *A-76* and is helping agencies with implementation).

"At the operational level, the lack of guidance from top management and the direct concern for the impact on the incumbent workforce often tends to initially cloud progress and objective decision making," says Geesey, who has been involved with *A-76* since its beginning. "Even the most objective managers at operational and mission levels, are greatly influenced by the human factor, particularly, and very often are unconvinced that the program will be administered fairly and impartially. Eventually, most accept the requirements and proceed in an orderly manner. However, there are signs of increased manuverings among those who remain unconvinced. Both are unhealthy and unacceptable."

Geesey adds that higher management often does not check the actions of operational managers. The result is that service contract industries conceive this as a deliberate effort to increase the unbalanced acquisition process in favor of the in-house workforce. The reasons are numerous but Geesey lists strikes, emergencies and security contract conditions. More serious trends include the problem of managers who try to reduce in-house capabilities unrealistically below that needed to actually perform the work requirement.

"Through ignorance others have established requirements far above those actually being performed or justified. In some cases they actually hoped to gain increased manpower staffing. As a result industry has found they are exceptionally competitive under these conditions and the in-house workforce found it was unjustly impacted.

In other cases, unrealistic requirements such as the provision for capital equipment by contractors performing on a three-year contract were established and in some situations attempts have been made to include one-time or unrealistic overhead costs in the cost analysis. These actions are not always caught in audits and are seldom identified when higher level management is not 'actively involved.' "

"There is now a more concerted effort to implement the policy," says Darlene Druyun, OFPP's Deputy Associate Director for Systems Acquisitions and Procurement Strategies, when asked to contrast the two Administrations.

The recently released *Bulletin (81-15)* on agencies' implementation of *A-76* "provides an audit trail," says Druyun. "Agencies are now required to provide us with back-up data instead of reporting that they 'waived commercial sources' or that conversions would 'disrupt their organizations.' "

Druyun explains the new bulletin contains more detailed requirements. These include (1) examining agencies functions through the out-years (2) setting procedures for agencies to reflect their commercial/industrial activities in their budgets (It is speculated that this may be the one place OFPP is trying to tighten the reins—not really a new emphasis) and (3) discouraging agencies from merely contracting out to meet personnel ceilings. Cost comparison, however, will remain intact—almost the backbone of the policy's implementation process.

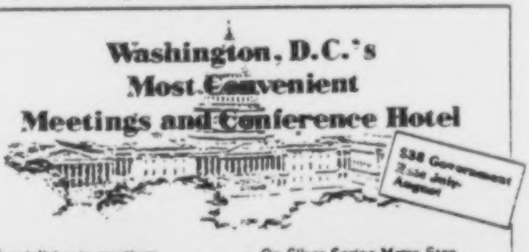
"Agencies will be forced to do in depth analysis of the status of their commercial/industrial and in-house activities, reflected in their budget assumptions and based on cost comparisons. Also included will be a stronger emphasis on the inventory process (including scheduling the inventory)," she adds.

The bulletin states that OFPP "will also provide assistance to budget examiners in reviewing the summary information, when required." When they obtain the information and find in their review that there are opportunities for reductions in fiscal years 1982 or 1983 budget estimates, OFPP program divisions will take appropriate action to: (1) Reduce the agency's request for program supplementals (2) Propose rescissions or deferrals of 1982 budget authority (3) Reduce the agency's request for the 1982 pay supplemental (4) Reduce the agency's request for 1983 or (5) Reduce the agency's personnel ceilings for 1982 or 1983.

Agencies' interpretation of these activities that are Governmental in nature can lead to the Government's "questionable" use or misuse of consultants. (The philosophy of "questionable" use was spurred in part by a flurry of Congressional inquiries on the subject last Fall). Although the Government's use of consultants for work which is inherently Governmental is probably more the result of poor management and manpower ceilings set by Congress, it is uncertain just how the Government employee's ambiguity with respect to defining "Governmental" will ultimately affect *A-76*.

Elmer Staats Letter to OMB Budget Director David Stockman summarizes the problem. "Recent audit work and Congressional hearings have shown that the Government is using contractors and consultants to (1) develop agency budgets (2) represent the Government in conferences with other contractors (3) contribute significantly to the establishment of Federal policies and program priorities from which they stand to profit and (4) negotiate Federal contracts with contractors."

OFPP plans to address this problem by combining its Circular *A-120* (which outlines a 5% agency-wide reduction for consulting and management services and special studies and analysis for FY 1981) with its *A-76* policy. "OMB *Circular A-120* is related to *A-76* and when agencies have long-range, long-term type consulting arrangements, the control mechanisms within *A-76* should be applied," says Druyun who plans to release this revision for public comment in the next few months. In addition, OFPP will expand and clarify the definition of functions which are Governmental in nature.



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Attachment B

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
Wednesday, June 3, 1981

STATEMENT OF EDWIN L. HARPER
DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS
ON THE
"DEPARTMENT OF DEFENSE AUTHORIZATION ACT OF 1982"
JUNE 3, 1981

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

THE OFFICE OF MANAGEMENT AND BUDGET APPRECIATES THE OPPORTUNITY TO COMMENT ON THE PROCUREMENT POLICY FEATURES OF H.R. 3519, THE DEPARTMENT OF DEFENSE AUTHORIZATION ACT OF 1982. WE HAVE ALSO INCLUDED COMMENTS ON S. 815 THE SENATE'S DEPARTMENT OF DEFENSE AUTHORIZATION ACT OF 1982.

BEFORE COMMENTING ON THE SPECIFIC ISSUES IN THIS BILL, I WOULD LIKE TO ADDRESS A MUCH BROADER ISSUE.

AS YOU ARE AWARE, PUBLIC LAW 96-83, "THE OFFICE OF FEDERAL PROCUREMENT POLICY ACT AMENDMENTS OF 1979" DIRECTED OFPP, AS ITS FIRST PRIORITY, TO DEVELOP A UNIFORM, COMPREHENSIVE AND INNOVATIVE PROCUREMENT SYSTEM FOR USE BY ALL FEDERAL AGENCIES, INCLUDING THE DEPARTMENT OF DEFENSE.

THE UNIFORM PROCUREMENT SYSTEM IS BEING DESIGNED TO CORRECT A HOST OF GOVERNMENT PROCUREMENT PROBLEMS. WE HAVE PROLIFERATION AND FRAGMENTATION OF FORMS, FUNCTIONS, LAWS, POLICIES, PROCEDURES AND REGULATIONS. PRESENTLY, THERE ARE TWO

BASIC STATUTES AND OVER 4,000 SEPARATE PROVISIONS OF LAW GOVERNING PROCUREMENT. FOR EXAMPLE, THERE ARE OVER 877 DIFFERENT SETS OF PROCUREMENT REGULATIONS CONTAINING A TOTAL OF 64,000 PAGES WITH APPROXIMATELY 22,000 PAGES OF REVISIONS EACH YEAR. THE NEW PROCUREMENT SYSTEM WILL BE DESIGNED TO UNIFY AND SIMPLIFY PROCUREMENT REGULATIONS FOR THE BENEFIT OF GOVERNMENT ADMINISTRATORS, PRIVATE SECTOR VENDORS, AND MOST IMPORTANTLY, THE TAX PAYER.

PUBLIC LAW 96-83 REQUIRES THAT AN INITIAL PROPOSAL FOR SUCH A SYSTEM BE PROVIDED TO THE CONGRESS BY OCTOBER 1980 AND THAT BY OCTOBER 1981, LEGISLATIVE AND MANAGEMENT PROPOSALS FOR IMPLEMENTING THE NEW SYSTEM BE PROVIDED TO THE CONGRESS. THE DOCUMENT SUBMITTED TO CONGRESS ON OCTOBER 27, 1980 IS AN INITIAL EFFORT, SERVING PRIMARILY AS A VEHICLE TO ELICIT THE VIEWS OF CONGRESS, THE PROCUREMENT COMMUNITY, AND THE PUBLIC IN GENERAL. SINCE THAT DOCUMENT WAS SUBMITTED, OFPP HAS CONTINUED ITS EFFORTS AND IS SIMULTANEOUSLY DEVELOPING (1) A REVISED PROCUREMENT SYSTEM PROPOSAL AS WELL AS (2) DRAFT *LEGISLATION* AND (3) A *MANAGEMENT* PROPOSAL FOR SUBMISSION TO CONGRESS IN OCTOBER 1981. WE BELIEVE THAT IT IS ESSENTIAL THAT THESE THREE PROPOSALS BE DEVELOPED SIMULTANEOUSLY SO THAT THE SYSTEM IS BOTH COMPREHENSIVE AND FULLY INTEGRATED.

THE HALLMARKS — OR *THEMES* — OF THE NEW APPROACH, TO BE REFLECTED IN EACH OF THE THREE PRINCIPAL PROPOSALS, WILL BE: MORE MEANINGFUL *COMPETITION* WITH LATITUDE FOR INNOVATIVE LOW

COST SOLUTIONS: INCREASED PERSONAL ACCOUNTABILITY AND PROFESSIONALISM IN THE WORK FORCE WITH LATITUDE FOR INITIATIVE AND JUDGMENT: A SIMPLIFIED SYSTEM — BOTH TIMELY AND RESPONSIVE (I.E., FAST TRACK); AND UNIFORM POLICY, REGULATIONS, CLAUSES, AND FORMS WITH NEEDED OPERATIONAL FLEXIBILITY. WHILE THE NEWLY DESIGNED SYSTEMS MAY INCLUDE SOME OF WHAT EXISTS TODAY, THE NEW DESIGN WILL DISREGARD EXISTING BIASES AND START ANEW. THE COMPREHENSIVE REFORM EFFORT MANDATED BY THE CONGRESS REQUIRES AN UNINHIBITED APPROACH TO, AND CREATIVE SOLUTION OF, ANY BURDENS AND INEFFICIENCIES ASSOCIATED WITH THE FEDERAL PROCUREMENT PROCESS AS IT NOW EXISTS.

WE BELIEVE THE PROCUREMENT PROCESS, BECAUSE OF ITS SIGNIFICANT IMPACT IN TERMS OF THE BUDGET AS WELL AS PERSONNEL SHOULD BE A UNIFORM INTEGRATED PROCESS THAT IS WELL DESIGNED AND THOUGHT OUT AS OPPOSED TO A PATCH WORK PROCESS THAT BECOMES SUCCESSIVELY WEAKENED BY EACH NEW ADDITION TO IT. AN ENORMOUS EFFORT IS ONGOING WITHIN OFPP AND THE AGENCIES, INCLUDING DOD. CLEARLY THIS IS THE WRONG TIME TO MAKE FURTHER CHANGES IN EXISTING STATUTES.

H.R. 3519 AND S. 315 CONTAIN SEVERAL CHANGES TO PROCUREMENT POLICY AND REGULATORY PROCEDURES WHICH, IN OUR OPINION, ARE IN SOME CASES PREMATURE, AND IN SOME CASES DUPLICATIVE OF EXISTING FEDERAL PROCUREMENT REGULATIONS. AS A GENERAL PROPOSITION, WE RECOMMEND THAT LEGISLATION BE RESTRICTED TO THOSE AREAS REQUIRING A STATUTORY BASE AND THAT DETAILED IMPLEMENTATION BE

LEFT TO REGULATIONS WHEREVER POSSIBLE. IN MY COMMENTS ON THE PROCUREMENT RELATED ASPECTS OF H.R. 3519 I WILL INDICATE THE SPECIFIC STEPS WE PLAN TO TAKE IN THOSE AREAS THAT WILL ULTIMATELY REQUIRE LEGISLATION AND ON THOSE AREAS WHERE REGULATIONS ARE PREFERRED.

REPEAL OF THE REQUIREMENT FOR AN ANNUAL REPORT ON INDEPENDENT RESEARCH AND DEVELOPMENT AND BID AND PROPOSAL COSTS

WE CONCUR WITH SECTION 204, WHICH REPEALS REQUIREMENTS FOR AN ANNUAL REPORT ON INDEPENDENT RESEARCH AND DEVELOPMENT (IR&D) AND BID AND PROPOSAL (B&P) COSTS. THIS REDUCTION IN REPORTING WOULD RELEASE RESOURCES FOR USE ON MORE CONSTRUCTIVE EFFORTS.

RESTRICTION ON CONTRACTING-OUT OF COMMERCIAL OR INDUSTRIAL-TYPE FUNCTIONS

SECTION 602 OF THE BILL WOULD PLACE ADDITIONAL CERTIFICATION RESPONSIBILITIES ON THE DEPARTMENT OF DEFENSE PRIOR TO AWARDING A CONTRACT FOR OPERATION OF A COMMERCIAL OR INDUSTRIAL TYPE FUNCTION. IN ESSENCE IT STATES THAT THE MILITARY COMMANDER OF THE MAJOR OPERATING COMMAND TO WHICH THE ACTIVITY IS ASSIGNED MUST CERTIFY THAT PERFORMANCE OF THE ACTIVITY BY A CONTRACTOR WOULD NOT ADVERSELY AFFECT MOBILIZATION, EMERGENCY OR CONTINGENCY MISSIONS NOW ASSIGNED TO THAT COMMAND OR THAT COULD BE ASSIGNED IN TIME OF WAR.

THIS CHANGE GOES IN THE WRONG DIRECTION. INSTEAD OF ADDING MORE RESTRICTIONS TO AN ALREADY BURDENSOME STATUTE, WE BELIEVE THAT A SIMILAR PROVISION (SECTION 502) OF THE FY 1981 DEFENSE AUTHORIZATION ACT AS WELL AS THE PROPOSED SECTION 602 OF THE FY 1982 ACT SHOULD BE ELIMINATED IN THEIR ENTIRETY. OMB CIRCULAR NO. A-76, WHICH ESTABLISHES POLICIES FOR THE ACQUISITION OF COMMERCIAL OR INDUSTRIAL TYPE ACTIVITIES, PROVIDES SUFFICIENT CONTROLS TO ENSURE THAT ACTIVITIES ARE NOT CONTRACTED OUT TO THE DETRIMENT OF NATIONAL SECURITY. THE CIRCULAR SPECIFICALLY PROVIDES THAT THE DEPARTMENT OF DEFENSE EXCLUDE ACTIVITIES FROM POSSIBLE CONVERSION TO CONTRACT WHEN COMBAT SUPPORT RESOURCES ARE AT STAKE.

SECTION 602 WILL UNDULY DISRUPT THE ORDERLY DECISION MAKING PROCESS OF THE DEPARTMENT OF DEFENSE. SPECIFICALLY, IT WILL THWART THE TRADITIONAL COMMAND AND CONTROL LINES AND SEVERELY HAMPER MANPOWER AND BUDGETARY DECISION PROCESSES WITHIN THE DEPARTMENT AS WELL AS THE OFFICE OF MANAGEMENT AND BUDGET. FURTHER I VIEW WITH CONCERN, THE ADDITION OF ANOTHER LAYER OF DECISION MAKING ON AN ALREADY LENGTHY PROCUREMENT PROCESS. MOBILIZATION AND WARTIME CAPABILITIES ARE THE CONCERNS OF DOD'S ENTIRE COMMAND STRUCTURE. UNNECESSARY LEGISLATIVELY IMPOSED CHANGES IN THAT STRUCTURE MUST BE OPPOSED IF WE ARE TO MAINTAIN AN EFFICIENT COMMAND STRUCTURE AND IF WE ARE TO CARRY OUT THE PRESIDENT'S MANDATE TO ELIMINATE WASTE. MAJOR CONTRACTING DECISIONS SHOULD BE EXAMINED BY DOD'S COMMAND STRUCTURE FROM A TOTAL WARTIME CAPABILITY RATHER THAN FROM THE NARROW PERSPECTIVE OF AN INDIVIDUAL COMMANDER.

SECTION 304 SHOULD ALSO BE REJECTED THIS SECTION EFFECTIVELY PRECLUDES THE DEPARTMENT OF DEFENSE FROM CONTRACTING OUT AN ENTIRE MEDICAL FACILITY. AGAIN, THIS LANGUAGE INTERPOSES ITSELF INTO THE ORDERLY DECISION MAKING PROCESS CONTEMPLATED BY OMB CIRCULAR NO. A-76. FOLLOWING THE PROCEDURES OUTLINED IN THE CIRCULAR, AN ENTIRE HOSPITAL WOULD BE CONSIDERED FOR CONVERSION TO CONTRACT ONLY WHEN NATIONAL SECURITY OR THE QUALITY OF MEDICAL CARE WOULD NOT BE AFFECTED. FURTHER, IT WOULD BE CONVERTED TO CONTRACT ONLY IF IT WERE COST EFFECTIVE TO DO SO. THE LANGUAGE IN SECTION 302 WOULD PREVENT THE DEPARTMENT OF DEFENSE FROM TAKING ADVANTAGE OF A POTENTIALLY MORE ECONOMICAL OPERATION. WE BELIEVE SUCH LANGUAGE SHOULD BE DELETED.

RESEARCH GRANTS

RELATIVE TO TITLE IX - GENERAL PROVISIONS, WE DO NOT CONCUR WITH SECTION 901, WHICH WOULD AMEND SECTION 10 U.S.C. 2358(1) TO PERMIT THE DEFENSE DEPARTMENT TO USE GRANTS IN LIEU OF CONTRACTS FOR RESEARCH PROCUREMENTS. UNDER P.L. 95-224 GRANTS AND COOPERATIVE AGREEMENTS ARE TO BE USED FOR ASSISTING THE PRIVATE SECTOR WHEREAS PROCUREMENT CONTRACTS ARE TO BE USED WHEN WE ACQUIRE GOODS AND SERVICES FOR THE GOVERNMENT'S OWN USE. ONE OF THE PURPOSES OF P.L. 95-224 WAS TO MINIMIZE THE POTENTIAL FOR ABUSE IN THE USE OF GRANTS. THE CONGRESS FOUND THAT GRANTS WERE BEING USED IN LIEU OF CONTRACTS TO AVOID THE LAWS AND REGULATIONS GOVERNING PROCUREMENT. SECTION 901 WOULD UNDERMINE THE INTENT AND EFFECT OF P.L. 95-224.

The Washington Post, June 6, 1981, Page A-18 Attachment C

Unneeded and Expensive Protection

IN THE RECENT debate over the inflationary effect of government purchasing policies, attention has focused on the Davis-Bacon Act, requiring payment of "prevailing wages" on all federally aided construction projects. Other federal practices, however, also deserve attention, among them the Service Contract Act, which applies the same prevailing wage requirement to the purchase of government services.

The Service Contract Act, like Davis-Bacon, started from the commendable notion that the federal government should be a "model contractor" in the sense that it should not use its considerable market power and its policy of competitive bidding to undermine existing wages, benefits and working conditions. While there is some reason to doubt the seriousness of this threat—as we remember the laws of supply and demand, when a big spender like the federal government enters a market the effect should be to drive wages up, not down—it is clearly possible that, in the case of low-skilled workers like cleaning crews, a competitor could organize a new crew and undercut whatever wage gains the previous workers had made.

While some protection for the most defenseless sort of service workers can be justified, extending the idea of wage maintenance to broad classes of workers is questionable. As amended several years ago, the Service Contract Act now applies potentially to such far-from-exploited groups as electronic technicians, computer programmers and student actors in Shakespeare on the Mall. The almost certain effect of "prevailing wage" requirements applied to groups like these is to push wages even higher.

With wages, job requirements and fringe benefits varying all over the marketplace, determining a "prevailing wage" is no easy task. A Carter administration study found that, faced with this chore, the Labor Department tended to either adopt the union wage scale or select a number well above the local area average for the service job in question. The study also found that wages of workers covered by the act increased more rapidly than those of other comparable workers since they were effectively protected from underbidding by competitors and the cost of wage increases could be passed on to the government. Requiring contractors to establish uniform pay and work practices is also a big administrative burden and an impediment to productivity.

The only thing that keeps the level of employer outrage over the Service Contract Act at a less than ferocious pitch is the Labor Department's relatively ad-hoc enforcement of its provisions. Attempts to make coverage more uniform and binding have met with sufficient resistance to force at least a temporary retreat. This, however, is not a satisfactory state of affairs. Keeping an unworkable law on the books simply because its full potential for mischief is currently unrealized is not a good idea. The scope of the law should be severely restricted, preferably by legislation, but at least by prompt and unambiguous changes in the Labor Department's regulations.

NEW YORK TIMES, June 20, 1981

Attachment D

JAMES RESTON

Stewart's Artful Resignation

Associate Justice Potter Stewart is leaving the Supreme Court of the United States at age 66, younger than most of its members.

Adlai Stevenson Jr. of Illinois quit the Senate at age 50, and John J. Rhodes of Arizona, the Republican leader of the House of Representatives, decided to get out at age 64, just when his party had visions of dominating not only the White House but both houses of Congress.

No doubt they had personal and different reasons for chucking it, butthey are symbols of a larger trend. For the number of resignations, not from the Supreme Court but from the executive and legislative branches, has been increasing in the last decade. And even The Wall Street Journal, which is not excessively sentimental about the established bureaucracy in Washington, reported the other day that "the U.S. government is suffering from a serious 'brain drain' of its most experienced top managers. . . ."

The Dollar Motives

There are many explanations, beginning with money. According to the General Accounting Office, federal executives' salaries increased by 35 per cent during the 1970s, compared with an 84 per cent increase for other federal white-collar workers, and a 125 per cent increase for private-service executives.

Also, federal government pensions, which rise with the cost-of-living index are more generous and available at an earlier age than most pensions in the private sector. And the one remaining result of President Franklin Roosevelt's "court-packing" experiment is that Supreme Court members may retire at 65 on full pay.

But money, or the declining value thereof in these inflationary days, is not the only explanation of this "brain drain," though it entices the best to leave earlier than the worst.

- In Congress, the rewards of seniority have declined. There is a growing feeling on the Hill that members are overworked, overextended by the tyranny of fund-raising demands and often overwhelmed by events beyond their control. They are proud to represent their districts, but the conflicts between private and public life, especially the tangles of keeping one house at home and another in Washington, are often almost too much of a burden.

- In the executive departments and agencies, there is the element of accident: A new administration, as now, comes to town, inevitably with its own ideas and people, which may eliminate programs that incumbents have been devoting their lives to for many years. They have to move over or move out.

- In the Foreign Service, there is an additional problem. This had been a man's world, staffed in the days of the nation's increasing responsibilities, beginning after World War I, by a remarkably competent professional staff of men; but it was also a world in which women did the secretarial dog-work and wives were the unpaid hostesses and managers of the embassies. This was unfair and long overdue for change.

Today, Foreign Service wives have jobs and careers of their own, which are not only essential to their personal dignity but in many cases necessary to the economic security of their families. So, understandably, they are not enthusiastic about following their husbands to countries where labor laws prevent them from pursuing their careers, and where they are expected to look pretty and serve tea while trying to silence the howling kids upstairs; the divorce rate in the Foreign Service is almost as troubling as the resignation rate.

The Magic Is Gone

On top of this, both Jimmy Carter and Ronald Reagan ran for office against the Washington civil servants, as if these people were the enemies of good government instead of the characters who kept the darned thing going. Reagan has appointed only one Foreign Service officer as ambassador to a Western European country – he sends them to the capitals where political friends and contributors don't want to go. As a result, the magic is seen to be going out of government service.

There is also the paradox that while big business here, competing as never before for the export markets of the world, tends to join in the chorus against the Washington "bureaucracy," it is the first to hire, at spectacular salaries, the government managers it has condemned.

No doubt there are some advantages in all this. Even if the best, rather than the worst, move out of Washington, they make room for change.

I found Potter Stewart in a philosophic mood about it all in his chambers on the day he resigned.

He was proud of the court's record in his 23 years, and optimistic about the country's future. We would adjust to change, he thought, maybe because we invented it.

There was no "hidden reason" for his resignation. He had had a long ride and just thought it was time to go.

He has demonstrated the art of resigning, but The Wall Street Journal is still right: the government is suffering from a serious 'brain drain' among its most experienced people and hasn't yet figured out how to recruit the best and get rid of the worst.

Attachment E

THE DEPARTMENT OF DEFENSE RESEARCH, DEVELOPMENT, TEST AND EVALUATION SUPPORT TO THE OFFICE OF THE SECRETARY OF DEFENSE AND THE ORGANIZATION OF THE JOINT CHIEFS OF STAFF
FY 1982

Statement of Record
to the
Committee on Armed Services
House of Representatives, 97th Congress, First Session

Mr. Chairman and Members of the Committee:

The FY 1982 Budget Request

The Office of the Secretary of Defense and the Organization of the Joint Chiefs of Staff request $28.103 million dollars in FY 1982 for outside research and analysis. These funds will be allocated as follows:

	Millions of Dollars
Under Secretary of Defense (Research and Engineering)*	$14.539
Assistant Secretary of Defense Program Analysis and Evaluation)	$ 3.181
Under Secretary of Defense (Policy)	$ 4.114
Director, Net Assessment	$ 3.634
Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics)	$ 2.635
	$28.103

Descriptions of the study programs supported by these allocations are attached as annexes to this statement.

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*Includes support for outside research and analyses for the OJCS.

WHY DO WE DO STUDIES

The Department of Defense undertakes external studies to provide a factual and analytic base for aiding in decisionmaking, and to assess the effectiveness of existing policies, programs, and practices. The emphasis of this external study program is on research, development, and acquisition. However, research studies covered by these program elements influence almost every area of defense policy making, planning, operations, programming, and budgeting. Without these studies our ability to manage our programs and meet our responsibilities both in the Department and to the Executive and Legislative Branches would be seriously impaired. Ultimately decisions are made on the basis of informed judgment. These judgments need to be made with the benefit of clear and accurate data; clearly defined issues and assumptions; and the absence of conflicting personal, bureaucratic, and organizational biases. Studies increase the quality of decisions by helping provide informed judgment.

These studies are performed by outside contractors to enable the Department to take advantage of: special areas of expertise neither available or necessary on a full time basis within the Government; broad industrial and academic talent; and experienced professionals no longer available for Government service. In addition, studies are performed by outside contractors to aid in discriminating among competing bureaucratic interests so that a reasonable degree of objectivity can be brought to bear on certain issues and problems. These studies are monitored and reviewed by competent DoD authorities to insure that the product will be beneficial to their needs and may satisfy the needs of others.

THE IMPACT OF STUDIES IN DOD

Given the purpose of studies, what do we do with the results? We:

o Evaluate and improve operations or procedures.

o Validate military requirements, tactics, strategy, and doctrine.

o Identify vulnerabilities, deficiencies, or weaknesses in our forces and systems and those of our potential enemies so corrections can be made in the case of our forces and exploitation in the case of enemy forces.

o Increase/improve effectiveness, efficiency, productivity or savings, in the use of our resources.

o Establish a long range investment strategy effort.

o Provide a rationale and priority for allocation of our resources.

o Identify longer term issues and problems stemming from an examination of key nationial and international security policy and program issues.

o Analyze options and alternatives to support policy, program, budget, and acquisition decisionmaking.

The results of just one study last year relating to DoD use of the Space Shuttle resulted in an estimated savings of $26M in investment and a potential annual savings of between $5M and $50M. This estimated savings was almost one and a half times the amount appropriated for OSD/OJCS studies in FY 1980. Yet another study on Tactical Fusion Centers led to potential cost avoidances on the order of $193M over the next five years. Lastly, a recent MRA&L study on Wage Board pay reform offers a potential savings of $500M over the next five years. These few examples demonstrate not only what we do with our study money, but that the result of just a few studies pays for the study program several times over.

With the increase in the magnitude and breath of the threats confronting this nation it is imperative that we spend funds allocated to national defense in this year's budget as effectively and as wisely as possible. We must examine existing and alternative policies, planning, operations, programs, and budgeting, (e.g., Are they realizable, effective, and efficient? Do they meet defense needs?). The technical support to OSD/OJCS contributes significantly to these examinations, assessments, and evaluations, thereby providing invaluable support in the acquisition decisionmaking process. These studies enable us to achieve needed balance and perspective on technology and strategy by providing unbiased outside experience and expertise which compliments in-house civilian and military knowledge of mission requirements, deficiencies, and threats.

In addition to their specific relevance to the near-term decision process, these analyses and assessments provide a framework to support the decisionmaker's understanding of the multi-faceted environment in the long-term context in which major defense problems and proposed solutions must be considered. A major commitment to Long Range Resource Planning has already begun in OSD starting with an in-depth analysis of the current PPBS and DSARC processes. Intelligent decisionmaking and resource allocation require a disciplined assessment and knowledge of threats, requirement trends, and progress in the technical-military areas of research, development, and acquisition.

The rapidity of change which characterizes the environment of today and for the foreseeable future intensifies the importance of maintaining a long-term perspective. Framing the right question, putting it into proper perspective, isolating those aspects which are as sensitive to change, and assessing the implications and consequences of choice for overall policy and strategy are important to the decisionmaker's selection of alternatives as the data and analyses pertaining to the immediate decisionmaking problem. In sum, our external research employs studies and analyses as a management tool to address the decision needs of today's environment and to lay the base for the environment and circumstances we would like to achieve in the future.

MANAGING OSD/OJCS STUDIES

In the last year the use of consultant services and studies has come under increasing scrutiny from the Congress, GAO, and OMB. Partly as a result of this criticism, but also for reasons of economy, cutbacks have occurred in study funds as part of the broader reductions in consulting services, because Congress and OMB have included studies in the same category as consulting services without any attempt to distinguish between the two. The Department of Defense makes a distinction among these services when it submits fiscal data about studies, consulting services, and management support services to the Congress because the Department believes they are separate and distinct categories. Studies are not consulting services. They are systematic, documented evaluations and assessments made to support the broad spectrum of objectives cited in the section above, "The Impact of Studies in DoD." Consultants are specific individuals and experts who give personal advice often without the preparation of reports. The use of such consultants is closely monitored by DoD. Indeed specific approval of the SecDef is required for such appointments.

In September 1980, the Military Departments and Defense Agencies were directed to establish improved management controls over the acquisition process for consultant services, studies, and professional management support. These instructions resulted from two OMB directives issued earlier in 1980. However, we expanded upon these directives in our Departmental guidance, because we perceive that the President and Congress are concerned not only about consulting services, but about management support service contracts and studies as well.

Within the last year the Department of Defense has initiated a number of management initiatives regarding studies. The DoD Ad Hoc Group on Studies was formed to provide guidance and direction for improving the management of studies in the Department. An improved Budget Exhibit for use with Congress was developed by the OSD Comptroller to provide a detailed breakout of funding sources and totals for studies and analyses, consultants, management and professional services, and engineering technical services. Work is under way to revise the current DoD Directive 5010.22 governing the management and conduct of studies. This new Directive, when approved, will set forth broad policy guidance for managing and controlling the conduct of studies in DoD while leaving the details for initiating and managing studies to the users. Lastly, to better document, justify, and demonstrate the end use of studies, the development of an improved management reporting system will begin this year. We believe this Directive, an improved management reporting system, continued attention to standards of conduct regarding contract awards, and increasing competitive awards to the maximum extent practicable are steps in the right direction to respond to Congress' concerns about studies.

An issue of growing concern to us is the decrease in competition available for studies. While we appreciate the Congress' concern with sole source awards, the practical effect of recent legislation (The Department of Defense Appropriation Act 1981) has been to decrease competition, exactly the opposite effect that was intended. For example, some of the smaller or newer companies, especially those with restricted cash flow or smaller staffs will be forced to go out of the DoD study business altogether since they will be unable to compete with the larger firms or may become captive subcontractors to larger firms. Because of these restrictions, many important ideas, approaches and concepts may never be nurtured or be used to address defense issues. Our ability to get timely studies underway will suffer due to the protracted nature of the competitive evaluation process.

There is a difference in competing multi-million or billion dollar procurement contracts and tens of thousands of dollar study contracts. The Department believes that these differences need to be recognized and allowances made in contracting procedures for these two types of procurement so that studies can be responsive to our needs. There is, in fact, an informal competition even for so-called sole source procurement of studies because there are always more ideas, approaches to be explored, alternatives to be developed, than there is money to fund such research. Thus the manager, policy maker, or analyst can select from many possible research proposals only the very best to fund in order to exploit those ideas and capabilities we do not possess in-house or cannot address with internal resources. Our ability to choose sole source proposals for funding with some degree of ease increases the number of new, independent and diversified views to which we are exposed.

Conclusions

Recent trends in funding the OSD/OJCS study program have inhibited our efforts to support the decisionmaking process in OSD/OJCS. The cumulative effect of these prior year reductions is to delay the start of priority projects, stretch out the completion of existing research, and reduce or eliminate a number of defined and needed studies. In addition, the cost of doing Congressionally mandated studies such as those on Critical Technologies and Critical Materials is borne by this regular OSD/OJCS studies budget.

Studies are a high leverage investment to support decisionmaking throughout the Department of Defense. As we have shown, the savings and program redirections from studies done last year have more than paid for the technical support to OSD/OJCS. They are utilized to address the myriad of complex issues and dynamic problems facing the Department, both in the long and short run. These studies provide us the capability to examine and assess the implications and consequences of current and alternative policies, plans, operations, strategies and budgets. Through such research we gain insight into the complex technological, military, political and acquisition environment in which future defense decisions and problems will be posed, considered, and made. Studies constitute an essential tool of management. They provide independent and objective analyses and new ideas for supporting the mission of the Department of Defense. I urge the full support of the Congress for the $28.103 million we are requesting.

Attachment F

THE WALL STREET JOURNAL; Tuesday, April 28, 198

Academic Business

Industry, Government Are Farming Out More Of Their Research

Fruits of Projects Include A Woodpecker Repellent And Sulfur-Base Asphalt

Clients Can Be Slow to Pay

By NEIL MAXWELL

Staff Reporter of THE WALL STREET JOURNAL

SAN ANTONIO, Texas—The scene is almost surreal. Certainly, it isn't typical of the surrounding ranch country. For, here, among the defoliated mesquite trees that jut from the gray earth, live 596 baboons. Some of them gesture menacingly at intruding visitors, while others glower, frolic or engage in amorous pursuits.

Nearby, men are tearing down brand-new General Motors engines and immediately rebuilding them. And white-frocked scientists are furnishing a room, only to set fire to it.

This isn't a new Fellini movie but the Southwest Research Institute and its associate across the road, the Southwest Foundation for Research and Education. The two exemplify an increasingly important service to American industry and government in the 1980s: private nonprofit research. The outfits are a blend of academia and business, run in the case of Southwest by a man who started out to be a concert violinist, who puts "good taste" above increased revenues, and who is reluctant to dun slow-paying clients.

Boom Times

The financial and technological problems of businesses that make for boom times on this 471-acre "campus" are having comparable effects on many similar institutions around the U.S. Business and government more and more are resorting to outside researchers for help with complex problems.

"As the world gets more complicated, you can't be the best in everything," says a spokesman for General Motors, one of Southwest's big customers, "and where we're not the best, we have the work done outside."

Southwest is one of the most varied and fastest growing of the nonprofit research ventures. Its revenues are expected to jump 25%, to more than $100 million, in the fiscal year ending in September. Because they are not-for-profit, Southwest and others in its league have no shareholders and pay no dividends. Earnings are ploughed back into operations. Southwest's government work is tax-exempt, but it does pay taxes on the income from private research.

"Right now we're terrifically overloaded, and the (applied-research) movement as a whole is doing very well," says Southwest's president, Martin Goland, who turned to mechanical engineering after concluding that he wasn't going to be a top-flight professional violinist.

Essential Work

The recessionary pressures that are squeezing much of the economy are helping the research business, and ironically, even Reagan administration cutbacks may not hurt, Mr. Goland says. "Industries reduce research-and-development expenditures when things get tough, but they still need work done, and it flows to us," he says. "And when the government puts on manpower limitations, the agencies immediately look outside."

At the Franklin Institute of Research in Philadelphia, which expects revenues of close to $26 million this year, compared with $22 million in 1980, a spokesman says one reason companies are using outsiders is that to do so entails "no investment in people or facilities. They don't have to hire a big staff and then terminate them when the project is done."

Other institutes are posting gains, too. Midwest Research in Kansas City saw revenues for the fiscal year ended in February rise to $58 million from $46 million, and it looks for another increase this year. Southern Research in Birmingham, Ala. expects about 10% growth from last year's $18 million in revenues.

The biggest of the private nonprofit institutions, Battelle Memorial in Columbus, Ohio, had revenues topping $400 million last year. Battelle views staff as a better measure of growth than dollars and sees its roster of 7,500 employes increasing by 3% this year. "We couldn't handle much more growth than that," says its president, Sherwood Fawcett.

Southwest was started in 1947 by Thomas Slick Jr., whose father had amassed such wealth drilling oil from Texas to Pennsylvania that he was called the "king of the wildcatters." Southwest was to be a conduit of high-tech information from research to industry.

Rural Sprawl

A few research assignments did trickle in, and the institute began to build a reputation that has spurred growth. Work initially done in one old ranch house now occupies more than 1,700 workers in 80-odd buildings sprawled around this hilly "campus." About 600 employes have academic degrees, mostly in engineering. A 19-member board made up for the most part of institute officers and San Antonio businessmen directs activities.

Southwest's projects typically cost customers between $50,000 and $150,000, although some have gone as high as $6 million or have cost as little as $500. Scores of projects are under way at once, ranging from the mundane to the bizarre.

The institute, for instance, is a major tester and certifier of lubricants, and has a big backlog of business. Manufacturers eager to document that their products meet industry standards must wait in line for 11 months even though the tests go on 24 hours a day every day but Christmas.

Oil tests involve stripping engines and rebuilding them to perfectionist standards, then racing them at 3,900 revolutions per minute for up to 10 days to see how engine oil holds up. Often it doesn't, as a tester demonstrates by tipping a glass containing oil too viscous to run down the side.

Emissions testing is also conducted here. Most of that analysis is done by sophisticated instruments, but sniffers have been employed too. At one time, human volunteers were enlisted to sit in 10 booths and inhale exhaust gases from funnels attached to hoses attached to diesels. There were lots of complaints about bus fumes. These days, because of cancer fears, baboons do the sniffing elsewhere to see if tumors develop.

The institute is also heavily involved in shale-fuel research and may spend up to $2 million for a micro-refinery making a gallon an hour of shale fuel at a cost of "hundreds of dollars a gallon, maybe thousands," says John Russell, the project director. In a still more esoteric project, Southwest is mixing slurries of coal and such things as sawdust from local mesquite trees to test as hybrid fuels.

Seriously considering mesquite as an alternative fuel may seem far out, but some of the institute's putative successes have stemmed from rank failures. One idea was to mold sulfur into huge, barge-shaped blocks and tow them overseas. Eliminating the cargo ship from the shipping meant there would never be a need for a return ship with an empty hold. "It was a crazy idea that just didn't work," says John Dale, the scientist behind it. Tests using models indicated the sulfur would break up in transit.

When the fuel crunch hit, however, Mr. Dale dug out his old sulfur data and realized the chemical element might make an ideal substitute for oil-based asphalt. The new compound of sulfur and various plasticizers is being tested on a 1½-mile stretch of highway near here.

Thankless but Vital Service

Southwest is one of the world's largest safety inspectors of nuclear plants. "We've got about 40% of the U.S. market as well as a lot abroad, and we've got the world's largest amount of inspection equipment," says C.E. Lautenheiser, the vice president in charge. Because the technology is always being upgraded, "we also have the world's largest junk pile of such equipment."

If obsolescence is a problem, so is the apathy of client utilities and plant builders who are obliged by the Nuclear Regulatory Commission to hire inspectors. "Every day we hold them up may cost them $750,000," Mr. Lautenheiser says.

In one case, a crack in a nuclear vessel that nobody but Southwest's ultrasonic specialists could spot held up construction for a year at a plant being built for Georgia Power Co., a unit of Southern Co. Repairs cost more than $500,000, Georgia Power says. It can't say how much the delay cost.

In at least two instances involving nuclear inspection teams, Southwest has been accused by its workers of shoddy work and falsifying records. The NRC found those charges groundless, but Southwest wasn't unscathed.

The Only Blot

The records didn't show a Southwest supervisor to be on hand when he should have been. And although Southwest insists it was only a record-keeping error, the NRC levied a $12,000 fine, which was paid by the utility, Boston Edison Co. "It's the only blot on our record," asserts Jack Harmon, Southwest's director of public relations.

But it isn't the only time Mr. Harmon has had public-relations problems. In a research project done for the Army, Pekinese dogs were exposed to the smell of guns, then rewarded with a morsel of food hidden in the trainer's fist. The idea was to teach the animals to react to a gun's presence.

The dogs were to be employed at government receptions to spot possible assassins. The project blew up when a newspaper got wind of it and reported erroneously that it was being done for the Secret Service. As a result of publicity and official concern about breached security, "I was investigated by the Secret Service, the FBI and everybody else," says Mr. Harmon.

Southwest does a lot of animal work. Currently being perfected is a repellent to keep woodpeckers off utility poles. Southwest is also training pigeons to spot insulation breaks in electric and phone lines. A Southwest official says the only problem is, "We can teach him (the pigeon) to find the break, but how do we teach him to tell us?"

Biting the Hand

Frustration is common in working with animals, says Ed Dean, the senior research scientist in the institute's department of bioengineering. His trained attack dogs sell for up to $15,000, and they do know how to attack. Mr. Dean has deep scars on his left arm, and he has only partial use of his right hand because his best learner ran amok. His dope-sniffing dogs not only sniff out opium but also can tell by smell in what country it was grown.

Here and across the road where the baboons are kept for breeding and research, scientific gains emerge from animal projects, but so does criticism. Antivivisectionist Amy Freeman Lee, who is a board member of the Humane Society of the U.S. and lives in San Antonio, doesn't like the animal experiments. "It is all cruel," she says. "No human being has an ethical or moral right to use any sentient creature in an experiment without its written consent."

Both the Humane Society and the Society for Prevention of Cruelty to Animals complained when several of 73 chimpanzees in a 1979 shipment from a lab in New York died at Southwest after the trip.

Cash-Flow Problems

While Southwest Research clings to its academic aura, it finds itself pushed toward pure business practices. For one thing, it now does 70% of its work for industry, 30% for government.

And Southwest has a split corporate personality in the matter of rising costs. Mr. Goland, puffing a black cigar in his office, says, "we could raise rates 5% or 10%, and it would have no effect on our clients." But, he adds, "there are certain things that are good taste and certain things that are not."

Such an attitude doesn't ease the job of Andrew Khourie, Southwest's top financial officer. "We're doing great getting projects, but what isn't going well is collecting money," he frets. The institute had to borrow $2 million to meet its own obligations because of slow-paying clients. And the interest on that could be going into new reseach, he says.

He also sees nothing he can do about it because of the institute's academic way of going about its business. "We never sue; we never press," he says. "We just beg."

Senator HAYAKAWA. Thank you, Mr. Hostetler.

Now we shall hear from Mr. Mike Roush, accompanied by Dr. Bennett.

STATEMENT OF MICHAEL ROUSH, NFIB, WASHINGTON, D.C., ACCOMPANIED BY DR. JAMES T. BENNETT, PROFESSOR OF ECONOMICS, GEORGE MASON UNIVERSITY

Mr. ROUSH. Thank you, Mr. Chairman.

On behalf of our nearly one-half million small business members, the National Federation of Independent Business is pleased to participate in these hearings on Government competition with the private sector.

We are encouraged by your interest in this issue as evidenced by your recent introduction of Senate Joint Resolution 93 to confirm and strengthen the Government's longstanding commitment to contracting out. We trust that these hearings will provide a forum for open and informative discussion.

NFIB's membership strongly supports you in your efforts because Government competition is a subject in which they are vitally interested. When we polled our members on this issue in March 1980, asking them whether the Government should be required to contract out to the private sector for goods and services whenever and wherever it is cost effective, the respondents voted 67 percent in favor of such a requirement.

NFIB's concern about Government competition stems from the inherent inequity that small business faces in attempting to compete with Government agencies in the production of goods and services.

In economic terms, in-house production translates into lost income for small firms, income which too often means the difference between success and failure of a business and always means loss of tax revenues to the economy as a whole.

In addition, Government production of goods and services necessarily raises the question of what the proper function of Government is in a free enterprise economy.

In 1979, we contracted with Dr. James Bennett, professor of economics at George Mason University, to study the practical effects of contracting out. With your permission, Mr. Chairman, I would like to introduce into the record his study on the subject. I have it here and will give it to the reporter.

Senator HAYAKAWA. Thank you. Without objection, it is so ordered.

[Material follows:]

TAX REDUCTION WITHOUT SACRIFICE:
PRIVATE SECTOR PRODUCTION OF PUBLIC SERVICES[*]

by

James T. Bennett
Professor of Economics
George Mason University

and

Manuel H. Johnson
Assistant Professor of Economics
George Mason University

[*] The authors gratefully acknowledge the research assistance of Peter Germanis and Donald Leavens.

Correspondence whould be sent to:

James T. Bennett
Department of Economics
George Mason University
Fairfax, Virginia 22030

TAX REDUCTION WITHOUT SACRIFICE: PRIVATE SECTOR PRODUCTION OF PUBLIC SERVICES*

I. Introduction

There is considerable evidence that taxpayers are dissatisfied with either the current level of taxation or with the level of public services provided by all levels of government in relation to taxes. By June, 1979, thirty states (of the required thirty-four) had adopted resolutions calling for a convention to enact a balanced budget amendment to the federal Constitution. In addition to California where limitations on property taxes were approved by a wide majority of voters in November, 1978, at least six other states have adopted measures which limit either government spending or taxes and similar resolutions are pending elsewhere. At the local level, the defeat of school bond issues and other spending proposals by voters also lends credence to the notion of a "taxpayer revolt." To some extent, higher taxes are the result of inflation, for the rising prices of goods and services and the appreciation of real property increases the tax take from income as sales taxes and property taxes rise. Further, as incomes rise, the typically progressive federal and state income taxes increase more rapidly than income. The taxpayers' frustration results not only from a higher level of taxation, but also from the fact that there is often little, if any commensurate increase in public services. This frustration may be the basic cause of the taxpayer revolt or the tax-limitation movement.

The principal argument offered by opponents of tax limitation measures is that legislatively-mandated reductions in government spending would produce serious economic and social dislocations because of the associated cuts required in public services. Even in the case of California where substantial tax cuts were enacted, it is argued that serious consequences were averted only by the offsetting allocation of a large state budget surplus to local governments. Ideally, it would be most desirable to have the best of all possible worlds: lower taxes without reductions in public services. This state can only be achieved by increasing substantially the economic efficiency of the production of public goods so that the same level of outputs can be produced at lower costs and the savings returned to the taxpayer in the form of tax reductions.

This paper investigates a simple alternative which can achieve the goals of a substantial reduction in the tax burden without requiring reductions in the level of public services. The basic thesis is that the production of public services by private firms would result in significant economies so that, even if output were held constant, taxes could be cut substantially. As shown in section II, private-sector, relative to public-sector, economies exist for two reasons. First, whereas public enterprises generally cannot achieve scale economies because markets are limited to political jurisdictions, private firms are not constrained by such boundaries which may be the result of some historical accident. Secondly, political firms are isolated from the competitive pressures of the marketplace and managers in the public sector have incentive structures which differ markedly from those of the manager in profit-seeking firms. Models of utility maximization are specified in section II which imply different behavior for public sector vis-a-vis private sector managers. Basically, it can be shown that, in the private sector, the self-interest of the manager is enhanced by increasing economic efficiency; this is not the case in the public sector.

From an economic perspective, public goods and services have externalities or spillover effects associated with their consumption. However, consumption externalities do not imply that there are spillovers associated with the production of these goods and services. Therefore, even if a public service is publicly financed, it does not follow that the service must or should be publicly produced. There are numerous examples of public production of goods and services which are also produced by the private sector. For example, at the local level of government, refuse collection, education, and fire protection are commonly provided by the public sector; at the state level, education and highway maintenance; at the federal level, ship repair and debt collection; all are activities in which private firms are also engaged. In section III, case studies of a variety of activities are surveyed in order to assess the relative efficiency of the public, in comparison with the private, sector. Overall, the public/private cost comparisons indicate that private production of public services, consistent with the model developed in section II, is far more efficient than public production. The last section contains conclusions and policy implications.

II. Organizational Structure and Economic Efficiency

There are two important reasons that private firms should produce goods and services more efficiently than public firms. First, the public firm generally serves a given political entity whose geographical boundaries may well have been the result of historical accident rather than a conscious economic decision. Therefore, the size or scale of operation of the public firm may not be optimal. Second, the public firm typically enjoys a monopoly market for its services which is created by government fiat. In such an economic environment, the public enterprise is largely isolated from the competitive forces of the marketplace and market incentives for efficiency are absent. Moreover, a vastly different incentive structure exists for the manager of the private firm vis-a-vis the manager of the public firm and it can be shown that the incentive structure in the public sector hinders rather than enhances the efficient provision of goods and services. Each of these issues is discussed in detail below.

The Optimal Scale of Operations. In contrast to the public enterprise, the private firm may adjust its scale of operations to exploit fully any economies of scale or to avoid any diseconomies which may be present in the provision of a particular good or service, because private enterprise generally is not constrained by political boundaries.[1] The public firm often serves all residents of the political jurisdiction so that the scale of operation is not determined by economic criteria, but by political considerations. If diseconomies exist, the political unit may be so large that an inefficient scale of operation is required. Alternatively, if economies of scale are present so that unit costs decline as size increases, the jurisdiction may be too small to capture the economic benefits of optimal size.

Even if the political entity is of ideal size for the production of a particular good or service, economic efficiency in the production of all services may not be achieved for two reasons. First, all goods and services provided by the government sector are not subject to identical scale economies. Hirsch (1973, p. 332) has shown from empirical evidence that urban public services exhibit different scale economies, as summarized in Table 1 below.

Table 1

Presence or Absence of Economies of Scale
in Various Urban Public Services

Horizontally integrated services:	
Police	No
Primary and secondary education	No
Refuse collection	No
High school education	Uncertain
Hospitals	Uncertain
Fire	Yes, but very minor
Vertically integrated:	
Water	Yes
Sewage	Yes
Electricity	Yes

Thus, given Hirsch's findings, the efficient provision of one service may imply the inefficient provision of another. Second, the optimal size for production of any service may differ from the optimal size for finance. These issues have been explored by Richardson (1969, pp. 202-203) who concluded that

> . . . there is no single size of urban government unit that is optimal for the satisfaction of all public wants. Some functions are best performed by large units, others by much smaller units. For this reason, a multilevel system of government will be much more efficient than a single unit system. An ideal theoretical solution might be to have a different structuring of urban

> government boundaries for the provision of each public service, but in practice the cumbersomeness of overlapping units, the interdependence of investment decisions in different public services and administrative inconvenience would lead to inefficiencies. Moreover, the level of urban government that is optimal for performing a given set of municipal functions may not be of optimal size for financing these services. Even if we could delimit the urban government area that best supplies a public service from the point of view of economic efficiency, this may not be the preferred size when subjective factors such as community participation potential and local identity considerations are allowed for.

Therefore, public production of goods and services is inherently inefficient because economies of scale and finance can not be realized.

Public Versus Private Incentives. Even if the scale of operation of the public-sector enterprise were optimal, the private firm would still produce goods and services more efficiently than the public firm because of the differences in the incentive structures between the two types of organizations. As mentioned earlier, the private firm must face the discipline imposed by the market mechanism. A firm which operates inefficiently runs the risk of incurring losses in the short run and being forced from the market by lower-cost competitors in the long run. The public firm, however, is insulated from such competition by a government-granted exclusive franchise. For example, the federal postal system is given exclusive rights in the delivery of certain types of mail and has used its legislatively-mandated powers to inhibit competition from the private sector. In other cases, alternatives are available, e.g., private as opposed to public schools, but the taxpayer often supports the publicly-provided service whether it is used or not. Therefore, an individual may not have the option of determining the quantity to be consumed when services are publicly provided. The only alternative for the taxpayer under these conditions is to change political jurisdictions, i.e., to "vote with his feet," or to attempt to elect officials who provide government services more efficiently.[2]

Because of the differences in economic environments, the managers of private-sector firms have incentives for efficiency which are vastly different from those in the public sector. Consider the utility function, U_P, for a given time period of the manager of a private firm specified in equation (1).

$$U_P = U(X_1, X_2, \ldots, X_n, \Psi, \pi) + \lambda_1(Y_P + \theta\pi - \sum p_i X_i) + \lambda_2[z \cdot f(z) - \phi(z) - \Psi - \pi] \qquad (1)$$

where

X_i = quantity of good i purchased, $i = 1,2, \ldots, n$;
Ψ = dollar value of managerial perquisites;
π = profits of the organization directed by the manager;
Y_P = salary of the private-sector manager;
θ = proportion of profits earned by the manager as a bonus ($0 \leq \theta \leq 1$);
p_i = price per unit of X_i;
z = quantity of output produced by the manager's organization;
$f(z)$ = price per unit of output z;
$\phi(z)$ = cost of production of output z; and
λ_1, λ_2 = Lagrangean multipliers.

The utility function is assumed to be smooth and twice differentiable with $U_i > 0$ for all i, and U_Ψ, $U_\pi > 0$, indicating increasing marginal utility. Marginal utility, however, increases at a decreasing rate so that the second partial derivatives, U_{ii}, $U_{\Psi\Psi}$, and $U_{\pi\pi} < 0$.

The specification of the utility function differs from the standard treatment in the economic theory of the consumer in that managerial perquisites (such as travel and a company-provided car) and profits appear as arguments. The level of profits is explicitly entered in the utility function because, in the private sector, a manager's performance and prospects for future promotions depend upon the profit the organization attains. As shown in the first constraint, the compensation paid to the manager consists of a fixed salary component, Y_p, and a bonus, $\theta\pi$, which depends on profit. Programs that permit the manager to participate in profits are common in the incentive structure of the private sector.

The second constraint indicates that profits are given by the difference between total revenue, $z \cdot f(z)$, the cost of production, $\phi(z)$, and the cost of managerial perquisites. The utility-maximizing levels of X_i, Ψ, and π, may be obtained by differentiating equation (1) with respect to these variables (and λ_1, λ_2) and equating the resulting equations to zero. In order to increase utility, the private sector manager must, ceteris paribus, increase perquisites, Ψ, or profit, π. As is apparent, however, there is a direct tradeoff between Ψ, and π, for each dollar expended on perquisites reduces gross profits by one dollar. As Williamson (1963, p. 1035) has observed,

> [The manager] would normally prefer to take . . . emoluments as salary rather than as perquisites of office since, taken as salary, there are no restrictions on the way in which they are spent, while if withdrawn as corporate personal consumption (such as expense accounts, executive services, office suites, etc.), there are specific limitations on the ways these can be enjoyed.

Williamson also noted that there are two reasons that perquisites may be preferred to salary: (1) tax advantages and (2) perquisites are less visible to stockholders and to labor and are less likely to provoke dissatisfaction. Therefore, some level of perquisites will be enjoyed by the manager, but not to the extent that a satisfactory level of profits (and bonus) is jeopardized.

If managerial perquisites are held constant, profits and, therefore, utility may be increased by either reducing the cost of output or by increasing revenue. Revenues can be raised by increasing prices only if the demand is price inelastic. However, the more competitive the market in which the firm operates, the greater the elasticity of demand and, since the quantity demanded is inversely related to price ($f'(z) < 0$), price increases can result in a loss of sales to competitors. For this reason, in a competitive market, the manager is under constant pressure to reduce the cost of production to the absolute minimum, i.e., to achieve a high level of economic efficiency. Efficiency permits the private-sector manager to maximize utility by achieving a high level of profits without sacrificing managerial perquisites. Thus, the discipline imposed by the operation of the market system provides inherent incentives for economic efficiency.

In sum, the private-sector manager is motivated by both the "carrot and the stick" in that he is rewarded financially and promoted for reducing costs and increasing profits and may be punished for unsatisfactory performance either by the actions of his superiors (through termination or demotion) or by competition from more efficient firms which may eventually drive the firm from the market. In the case of the government bureaucrat, however, neither the carrot nor the stick operates to encourage efficient performance. As is well known, it is very difficult to terminate government employees even for poor performance; the low rates of employee turnover in the public sector relative to the private sector provide empirical evidence in support of this assertion. Moreover, the manager of a government bureau has, at best, only minimal incentives for economic efficiency.

Consider the utility function of the bureaucratic manager, U_B, in equation (2).

$$U_B = U(X_1, X_2, \ldots, X_n, \Psi, N) + \lambda_1(Y_B - \sum p_i X_i)$$

$$+ \lambda_2[\Psi + W \cdot N + \phi_B(z) - B] \qquad (2)$$

where X_i, p_i, Ψ, λ_1, and λ_2 are defined as in equation (1) and,

N = number of employees supervised by the bureaucrat;

Y_B = salary of the bureaucratic manager;

W = average wage of the bureaucrat's subordinates;

$\phi_B(z)$ = Cost of producing bureau output, excluding labor costs; and,

B = budget appropriated by the sponsoring governmental unit for the manager to operate the bureau (excluding the manager's salary).

As before, the utility function is smooth, twice differentiable and has positive first-order derivatives and negative second-order direct partial derivatives. The bureaucratic manager, like his private-sector counterpart, enjoys increasing utility as perquisites of office increase, but there is no tradeoff for the bureaucrat between emoluments and pecuniary income. The bureaucrat does not financially benefit from cost reductions since he does not obtain increased income, for as shown in the first constraint, the only income available to the bureaucrat is the salary received from employment. The number of subordinates appears as an argument of the utility function because, as Tullock (1965, p. 134) has observed, "in most American and European governmental bureaucracies . . . [a bureaucrat] is rewarded . . . for simply increasing the number of inferiors that he supervises."[3]

The second constraint in equation (2) indicates that the budget appropriated for the operation of the bureau, B, is exhausted by spending on perquisites, salaries of subordinates ($W \cdot N$), and the non-labor cost of producing the output, $\phi_B(z)$. If the bureaucrat serves his own interests, he will always spend the entire budget allocated to his bureau. Promotions, prestige, and increases in salary depend upon increasing the number of subordinates which the public-sector manager supervises. An increase in bureau employment, however, requires an increase in the appropriated budget. The bureaucrat would find it difficult to justify budget increases in the next period if the budget in the previous period was not totally expended. For this reason, in federal, state, and local governments, it is commonplace for bureaus to accelerate their procurement activity toward the end of the fiscal year in order to insure that all allocated funds are spent.

As is evident from equation (2), the bureaucrat can increase his utility by increasing the perquisites of office. Given that the bureau's budget is exhausted in each period, however, increasing the spending for perquisites requires a reduction in the agency's wage bill or a reduction in the non-labor cost of producing the agency's output, $\phi_B(z)$. Since utility also depends on the level of employment, there is little incentive to reduce the agency wage bill. As Bennett and Johnson (1979) have shown, however, the bureaucrat, once the agency budget has been established, attempts to shift the cost of agency output to the private sector so that additional funds are available for perquisites. Further, because of the nature of the services produced by the public firm and the budget process itself, there are few benefits to be achieved from reducing the cost of output. More specifically, the services produced by the public firm are typically very labor intensive, e.g., refuse collection, education, and police and fire protection. In addition, in the public sector, "operating" budgets are frequently appropriated independently of "capital" budgets. Thus, the appropriation process itself may inhibit the bureaucrat from making tradeoffs between capital equipment and labor services. It might also be noted that one of the nonpecuniary perquisites of bureaucratic management arises from a much lower level of pressure to increase efficiency. Alchian and Demsetz (1972) show that there is a greater incentive for "shirking" in public than in private enterprise, for the public employee's wealth is not affected by his decisions.

Relative to the private sector, the incentive structure for the bureaucratic manager is perverse. Not only are incentives for economic efficiency largely, if not totally, absent, but also every bureaucrat is inherently an empire builder who seeks to enlarge the size and scope of his agency in order to increase status and salary. Factors other than efficiency and cost-minimization motivate the public-sector manager, although some modicum of efficiency must be achieved to avoid reprisals from the agency sponsor. In theory, the elected politicians who appropriate the budget allocation of the bureau maintain control of the bureau's activities and insure efficient production of the bureau's output. In reality, however, it is difficult or injudicious for the politician to carry out rigorous oversight functions for a number of reasons. As Downs (1967, p. 30) has noted, an essential characteristic of bureaucracies is that ". . . [there is] no direct way of evaluating their outputs in relation to the costs of the inputs used to make them." For example, how does one measure the output of such acitvities as education, national defense, police and fire protection, and health care services? In cases where outputs are difficult and costly to measure, inputs such as the number of teachers or students in education or the number of personnel and ships in national defense, are used as surrogates for output. The politician, therefore, generally associates increases in inputs funded by budget increases with increases in output.

The self-interest of the politician is also served by a public sector that is growing in employment. In simple terms, the goal of the politician is to remain in office. Public-sector employment offers an attractive means of providing patronage to the politician's supporters. In addition, as Bush and Denzau (1977) have shown, government employees have a vested interest in the growth of government and, because of this interest are very active politically. Relative to the general public, they vote in greater proportion and have a correspondingly disproportionate impact on political decisions.

Finally, the politician generally creates a monopoly for the public-sector firm and constituents who pay taxes would be greatly displeased by an interruption in service when there are no alternative sources of supply. Voter displeasure might be detrimental to the politician at election time so that there is little incentive to stress cost cutting efforts which might lead to strikes or work slowdowns by public employees. De Alessi (1974, p. 7) has asserted that "Government firms, particularly those endowed with a politically influential clientele, can survive for long periods, and their managers prosper, in the presence of persistent deficits (let alone economic losses) and grossly inefficient management." The rate of growth of government is, of course, constrained by the growth of tax revenues. The politician, particularly in an election year, is adverse to voting for higher taxes, but in times of inflation, tax revenues increase automatically as property assesments increase at the local level of government and the progressive income tax structure increases the take of government at the state and federal level.

The effects of the bureaucratic incentive structure have long been recognized. For example, thirty-five years ago, Ludwig von Mises (1944, p. 1) began his classic book, Bureaucracy, in the following way:

> The terms bureaucrat, bureaucratic, and bureaucracy are clearly invectives. Nobody calls himself a bureaucrat or his own methods of management bureaucratic. These words are always applied with an opprobrious connotation. They always imply a disparaging criticism of persons, institutions, or procedures. Nobody doubts that bureaucracy is thoroughly bad and that it should not exist in a perfect world.

Mises' description of the connotation attached to bureaucracy is more accurate than apocryphal. Attitudes toward bureaucracy are based upon the observation that bureaucratic methods are inefficient and wasteful. The incentive structure for the manager of a government bureau described above implies that the private sector should be a much more efficient producer of goods and services than the public sector. Even if the incentive structures were identical, one would expect the private-sector to outperform the public-sector because private firms can achieve economies of scale, whereas the public enterprise cannot because of political boundaries. Although it is difficult to measure the output of the public-sector in absolute terms, it is possible to make relative comparisons between public and private-sector production costs for the same service.

III. Private/Public Efficiency in The Production of Services: The Empirical Evidence

A number of studies have empirically investigated the relative efficiency of the private vis-a-vis the public-sector in the provision of a variety of services including refuse collection, fire protection, debt collection, health care and hospital service, ship repair, and the operation of utilities and airline services. Some of these activities are regulated by government, e.g., those of airlines, utilities and hospitals. Moreover, health facilities are also often regulated through the accreditation process by private associations. Regulation, especially that which guarantees a specific rate of return, reduces the incentives for cost minimization and may also inhibit the firm from achieving an optimal scale of operations. For example, airline routes are often allocated and utilities must provide service to all users in their service area. Yet, as discussed below, the private sector, despite such restrictions, has been found so consistently more efficient that Borcherding (1977, p. 62) has proposed the "Bureaucratic Rule of Two: removal of an activity from the private to the public sector will double its unit costs of production." The empirical findings on public/private relative efficiency are reviewed briefly for each activity; evidence is then presented on the labor intensity and the adoption of technological change in private vis-a-vis public firms.

Refuse Collection. Refuse collection is, for three reasons, of particular interest. First, this technologically simple activity which is carried out at the local level of government by public operations, and by private firms as well, illustrates many of the problems associated with making public/private cost comparisons. Second, in contrast to firms which are regulated or are constrained to a given service area or route configuration, private garbage firms may seek economies of scale. Third, because there are are virtually no economic barriers to entry --- large amounts of capital are not required --- in the absence of government restrictions on entry, trash collection in the private sector should be fiercely competitive and pressures for cost minimization especially intense. Although these considerations imply that refuse collection should clearly show the superior efficiency of the private sector, the empirical evidence is conflicting.

Hirsch (1965) found no significant differences between public and private costs of residential refuse collection. A study cited by Spann (1977, pp. 83-85) for communities in Monmouth County, New Jersey appears to show that the average per capita costs of trash collection is seventy percent higher when services are provided by the public sector, but these data must be interpreted with caution, for no attempt was made to hold all other factors constant accross observations. Kemper and Quigley (1976, p. 110) concluded from their econometric analysis of garbage collection in various Connecticut jurisdictions that "Collection cost appears to vary systematically with the organization of collection, even after controlling for other factors. Private collection appears to be about thirty percent more expensive than municipal collection, which, in turn, appears to be about twenty-five percent more expensive than contract collection." The finding of Kemper and Quigley is supported by Stevens (1978, p. 445) who found that "the competitive arrangement is from 26 percent to 48 percent more costly than the private monopoly arrangements." Stevens' data consisted of observations on 340 public and private firms operating in an equal number of cities. On theoretical grounds, but without supporting empirical evidence, Young (1972, p. 73) also asserted that municipal contracting with a private firm is less costly than either private or municipal collection of trash. In contrast, Kitchen (1976) reported that private collection of garbage is far less costly than municipal collection in 48 Canadian communities, each with population in excess of 10,000.

The evidence on the existence of economies of scale is as conflicting as that on the most efficient method of collection. As noted in Table 1, Hirsh believes that economies of scale do not exist, as do Kemper and Quigley (p. 34); Stevens (p. 443), however, argues that scale economies are present for large and small firms, but not for firms of intermediate size.

Clearly an explanation which resolves some of the discrepancies among the studies of refuse collection and provides a more satisfying interpretation is needed. A major weakness of all previous studies of private versus public cost of garbage collection is that municipalities are employed as the unit of observation. As is well known, there is little comparability among the budgeting practices of different municipalities because of the lack of rationality in the budgeting of costs by function within individual governmental entities. Indeed, as Kemper and Quigley (pp. 56ff) recognized, an individual municipality may not even be aware of the true cost of municipally-provided services: "Although municipalities typically maintain a separate budget and expenditure account for refuse collection, these figures seldom include all of the costs that are properly attributed to that service." From the outset, then, cost comparisons are biased in favor of the municipality. This bias can be sizable; Kemper and Quigley estimated for fiscal year 1972-1973 that the budget figures for refuse collection for Hartford, Connecticut underestimated the true cost by 41 percent, because the costs of vehicle operation and maintenance, interest, and depreciation were not included in the budget. Further, the concept of opportunity cost is virtually unknown in government bureaucracy and foregone property tax revenues resulting from municipal collection of garbage (which understates the true cost of municipal collection) was estimated to be an additional 2.3 percent of Hartford's budget for trash removal (p. 57). None of the studies considers the future cost liabilities incurred on behalf of the taxpayer for the pension payments of retiring municipal employees. Pension benefits are substantial (Bahl and Jump, 1975; Jump, 1976; Perham, 1976) and their omission also produces a downward bias in the costs of municipal collection relative to private collection.

Because of the inherent difficulties involved in identifying and assessing the relevant costs of public trash collection in a given municipality and the lack of comparability among various municipalities, a more valid approach is to use the prices charged by private firms in a single governmental unit as the basis for comparison with the fees charged by the municipality for public collection. This approach requires that private collection of trash coexist with public collection in the same jurisdiction. Such cases, however, are not rare; Bennett and Johnson (1979) analyzed refuse service charges for a single jurisdiction in the Virginia suburbs of Washington, D.C., where 29 private firms serve almost the same geographical area as the public enterprise. The empirical findings indicated, after adjustment for frequency of service and for income tax deduction benefits to homeowners, that public service was about twice as costly as private refuse collection.

The existence of a large number of small firms would seem to deny the presence of economies of scale. Other investigators whose empirical analyses support the scale economies argument, without exception, employ regression analysis as their empirical technique. Economies of scale are indicated by a significant coefficient for a nonlinear size variable. However, regression coefficients must be interpreted individually on a ceteris paribus basis, i.e., all other variables held constant. But in garbage collection firms, ceteris are not necessarily paribus, because wage rates may vary with firm size. Large firms may be unionized and pay union wages, whereas small firms may be family operations and have labor contributed by family members. Indeed, Stevens (p. 443) recognized that "monthly wages of collectors was positively correlated with total costs" and, as would be expected, total costs increase with size. In computing scale economies, it is therefore necessary to allow wages to vary with firm size rather than assume this very important component of cost to be held constant. For this reason, the evidence presented thus far on the issue of scale economies is inappropriate.

Fire Protection. Although fire protection is a public service which is generally produced by public firms that use either volunteers or paid employees, one community, Scottsdale, Arizona, contracts for this service with a private firm. Ahlbrandt (1973), using data for forty-four cities and five districts in the state of Washington, estimated the cost of provision of fire service per capita as a function of population, area served, fire insurance rating index, number of personnel, and other variables. The model, estimated with data from cities in Washington, was verified for cities in Arizona by showing that it correctly predicted actual per capita fire protection costs for Arizona cities. For the city of Scottsdale, the model predicted that actual costs per capita would be $7.10 if fire protection were provided by a bureaucratic producer. The private firm serving the city, however, was paid $3.78 per capita, a cost savings of

$3.32 per capita or approximately 47 percent. Alternatively, if the public sector were to provide the fire protection instead of the private sector, per capita costs could be expected to almost double.

The after tax profit rate for the private company was regulated not to exceed seven percent of gross revenues. Although such regulation might be expected to attenuate incentives to reduce costs, Ahlbrandt (1973, p. 10) asserted that this was not the case.

> . . . there is an incentive for the company to minimize costs. Growth is predicated upon being able to maintain current customers and develop new sources of business. If costs are not kept in check, newly formed communities will not have an incentive to purchase the service and existing customers may seek alternative sources of supply. Potential competition exists in the form of the threat of the municipality producing its own service or contracting with another producer.

The fire insurance rating for Scottsdale is no different from that of other comparable cities which indicates that, although the cost of provision of fire service in Scottsdale is significantly lower, the quality of service provided is comparable. A major cost saving for the private firm is that employees are used to construct the company's equipment. The equipment built in-house lacks the fancy chrome and other accoutrements so typical of the traditional fire engine. The accessories can add thousands of dollars to costs, but add nothing to firefighting ability.

Debt Collection. The federal government is not only the nation's largest debtor but is also its largest creditor --- the General Acounting Office (1979a, p.i) reported in 1979 that $118 billion was owed the federal government. The level of receivables is large in absolute terms and rapidly growing, for the amount due the government increased by $15 billion, or 21 percent, during fiscal year 1977. Like the private sector, the federal government is plagued by nonpayment; the Treasury Department reported that the allowance for bad debts was $3 billion at the end of fiscal year 1976, an increase of 35 percent over the prior fiscal year. Unlike the private sector, however, the government takes a highly cavalier attitude toward collection. The Comptroller General reported to Congress (GAO, pp. i-viii) that only three of twelve agencies audited established allowances for uncollectible accounts and most agencies simply write-off debts and make no attempt to collect them. In fact, many debts arise from bureau errors in making overpayments (the Social Security Administration had made excessive payments totaling $1.5 billion as of September 30, 1978). Thus if these debts were collected, bureaucratic errors in payment would be exposed.

The GAO report (p. iii) stated that "[federal government] collection methods are expensive and slow compared with commercial practices and are not cost effective in dealing with debtors who delay or try to avoid paying." Generally the government does not seek judgement on debts of less than $600, whereas commercial firms surveyed asserted that it was cost effective to pursue collection to the point of court judgement for claims as small as $25. The GAO found that one large agency spent an average of $8.72 to pursue collection, but that comparable costs for a commercial firm were less than $3.50 for the same operations. In the private sector, court judgements are normally sought within five months, but the federal government collection process which proceeds to the same point normally takes a year, and frequently much longer. Therefore, by the federal government's own assessment, the bureaucratic debt collection process, when undertaken at all, is far less efficient than its private counterpart. Although government bad debts increase the tax burden and the federal deficit, agencies are now prevented from employing private collection agencies, except when given explicit legislative authority.

Health Care and Hospitals. Studies of public versus private health care and related issues have been conducted by Frech (1976), Clarkson (1972), and Lindsay (1976). Frech analyzed the performance of profit-seeking and nonprofit firms in processing Medicare claims under contracts from the Social Security Administration. Three measures of performance were used: cost per dollar of claims processed, average processing time in days, and number of errors per $1,000 of claims processed. The means and standard deviations (shown in parentheses) are given in Table 2 for each performance measure for the twelve profit-seeking firms and the 66 nonprofit firms in Frech's sample.

Table 2

Performance Measures for Medicare Claims Processing, by Type of Firm

Performance Measure	Profit-seeking Firms	Nonprofit Firms
Cost per Dollar Processed	$ 0.0715 (0.0178)	$ 0.1039 (0.0331)
Average Processing Time (Days)	18.70 (10.34)	33.59 (19.83)
Errors per $1,000 Processed	0.1844 (0.0717)	0.4426 (0.7576)

Source: Frech (1976, p. 147).

As is apparent from the table, nonprofit firms have processing costs that are 45.3 percent higher, average processing times almost 80 percent higher, and an error rate 140 percent greater than profit-seeking firms. In addition, the profit-oriented claims processor has, without exception, a much smaller standard deviation for each of the three performance measures, indicating that the variation among profit-seeking firms is much smaller than among the nonprofit firms. The differences are highly significant statistically.

Although the nonprofit organizations which Frech described are not necessarily governmental entities, the incentive structure is very similar because the profit motive does not operate. It is also interesting that, by means of regression analysis, Frech (p. 151) reported that nonprofit firms operated at an inefficiently low level of scale and concluded that "apparently nonprofit firms not only choose inefficient points on their cost surface, but the entire surface is higher for them." Thus, even though a nonprofit organization may not be limited to a particular scale of operation based upon political considerations, there is no guarantee or incentive for such organizations to operate at optimal size.

Kenneth Clarkson investigated differences in operating characteristics and costs of proprietary and nonproprietary (nonprofit private and governmental) hospitals. Based on surveys of general hospitals, he found that nonproprietary hospitals were more "bureaucratic" than proprietary hospitals in that the "nonprofits" were more likely to have a written set of staff regulations, regular scheduled staff meetings, standing committees on the staff, and restrictions on surgical privileges. Proprietary hospitals were also found less likely to give automatic salary increases to employees.

Clarkson (p. 378) also provided a comparison of mean weekly wages for twenty-six occupations for employees of nongovernmental and governmental hospitals in Los Angeles and in San Francisco. In the Los Angeles sample 47 percent of the nongovernmental hospitals were proprietary and, for twenty-five of the twenty-six occupations, the nongovernmental weekly wage was below the weekly wage at governmental hospitals. In some cases, the wage differences were substantial, e.g., nursing directors were paid 34 percent more in governmental hospitals. Only medical record librarians were paid less. None of the nongovernmental hospitals in the San Francisco sample was proprietary and, in this case, governmental hospitals paid a higher weekly wage for twenty-two of the twenty-six occupations. The average weekly wages are significantly higher across occupations in governmental hospitals in the Los Angeles sample, but not in the San Francisco sample, which indicates that the wage behavior did not differ statistically between nonproprietary private and governmental hospitals; further, proprietary hospitals pay average weekly wages that are lower than nonproprietary hospitals whether the latter are private or governmental. Evidently, the greater the attentuation of profit incentives in the organization, the less emphasis given to obtaining personnel at wage rates comparable to the proprietary hospital.

In only one instance, to our knowledge, is there direct evidence that governmental hospitals are more cost effective than private hospitals. Lindsay (1976) reported that the per diem costs of Veterans Administration hospitals were substantially lower than at proprietary hospitals. However, this finding does not contradict the assertion that profit-oriented enterprises are more efficient than nonprofit firms, because Lindsay showed that the quality of care was much lower in VA hospitals than at private facilities. In bureaucracies, managers devote resources to the measures of output that are monitored by the bureau sponsor. Because medical care is difficult to measure directly, costs or costs per patient day are often used as surrogates. It is obviously much less expensive to care for a patient who is not seriously ill than a very ill patient. In order to minimize costs per patient day, patients may be held in the governmental hospital much longer than in a proprietary hospital for the same medical procedure. As shown in Table 3, Lindsay presented evidence which indicates that the average length of stay is much longer at VA than at voluntary hospital for the same surgical procedure. Therefore, because the quality of care is very different between VA hospitals and voluntary hospitals, the conclusion that bureaucratically produced health care is less costly is unjustified, for improvements in quality would raise unit costs.

Table 3

Average Lengths of Stay in VA and Voluntary Hospitals by Surgical Procedure for Patients 50-64 Years Except Where Noted (Reported by Days)

Procedure	VA	Voluntary	VA/Voluntary
Pilonidal Cyst (35-49)	15.7	5.8	2.71
Diabetes mellitus	19.0	9.0	2.11
Acute coronary occlusion . . .	31.5	21.7	1.45
Hemorrhoidectomy	15.3	7.1	2.15
Tonsils and adenoids (35-49) .	6.4	2.4	2.67
Duodenum ulcer	15.2	6.7	2.27
Appendicitis	12.1	6.9	1.75
Inguinal hernia	17.1	7.2	2.38
Gastroenteritis and colitis .	11.1	7.7	1.44
Gallstones	26.5	11.9	2.23
Pyelitis, cystitis, nephritis	11.6	6.0	1.93
Kidney stones	18.6	8.2	2.27
Prostate	22.1	9.7	2.28

Source: Lindsay (1976, p. 1073).

Ship Repair. Navy support ships are, in many ways, similar to merchant marine vessels; for example, fleet replenishment oilers which refuel navy ships at sea have characteristics much like merchant tankers. In fact, between 1971 and 1977, commercial tankers under contract conducted more than 90 underway refueling operations for the Military Sealift Command (U.S. General Accounting Office, 1978b, p. 8). There are, however, substantial differences between commercial and naval ships in the amount of time spent at sea and in the cost of maintenance. Although naval support ships are on sea duty only about 20 percent of the time, comparable commercial vessels are under way between 40 and 70 percent of the time. Because the wear and tear on equipment is greatest when a ship is at sea, it would be expected that, for comparable equipment, commercial vessels would experience maintenance costs between 2 and 3.5 times as great as naval ships, on the average. Such is not the case. Overall, the GAO (1978b, p. i) found that the "Navy's maintenance costs per ship average about $2 million a year compared to about $400,000 a year for a commercial ship." Naval/Commercial costs and cost ratios for similar items of equipment are shown in Table 4. The naval/commercial maintenance cost ratios for similar equipment items range from a low of 3.3:1 to a high of 51.8:1, which clearly indicates that commercial maintenance costs are much lower on comparable equipment than naval costs.

Table 4

Comparison of Maintenance and Repair Costs for
Similar Equipment Items on Navy Oilers and Commercial Tankers

Equipment Item	Naval Oilers	Commercial Tankers	Cost Ratio
Boiler refractory	$40,270.50	$2,860.50	14.1:1
Pumps, main feed	32,035.00	618.00	51.8:1
Pumps, cargo	80,380.80	3,328.00	24.2:1
Pumps, fire and flush	25,921.60	1,221.00	21.2:1
Propeller shaft, bearings	36,829.60	2,745.00	13.4:1
Turbines, nonengine	20,823.00	6,394.00	3.3:1
Turbines, service generator	66,111.20	4,044.00	16.3:1
Valves, safety	3,620.00	288.00	12.6:1

Source: U.S. General Accounting Office (1978b, p. 42).

In addition, whereas the typical naval support ship spends between 30 to 68 days in repair each year, the commercial counterpart is out of service for only 11 to 31 days annually. This finding is particularly surprising, for a naval ship is of little, if any strategic value while in port undergoing maintenance. One would expect that, as much as possible, naval repairs would be made during operations at sea. However, the reverse is true in that commercial ships make as many repairs as possible while under way and naval ship repairs are typically made in port. This is especially unexpected in view of the fact that commercial vessels carry a crew that is only a fraction of the size of the crew on naval ships. Among the 86 ships in the sample of commercial ships, the largest number of staff was 46, whereas the smallest crew size among the 58 naval support ships was 92; overall, naval crew size (exclusive of troops) ranged as high as 1,438 with an average of 555. (Op. Cit., 1978b, p. 27 and pp. 53-54).

The General Accounting Office report concludes that the Navy could reduce maintenance costs dramatically without significantly affecting readiness of the fleet by adapting commercial maintenance practices. Some years ago, it might be noted, naval shipyards ceased construction of new naval ships and all new construction was contracted out to private yards, because construction costs were significantly lower at private facilities which were awarded competively-bid contracts.

Utilities. Considerable research has been conducted on various aspects of publicly-owned versus privately-owned electric utilities by Peltzman, (1971), Pike (1967), Moore (1970), De Alessi (1977), and others. An excellent survey of much of this material has been provided by De Alessi (1974, p. 36), who concluded that

> . . . the evidence suggests that municipal firms, relative to privately-owned regulated firms in general will: charge lower prices; have greater capacity; spend more on plant construction; have higher operating costs; engage in less wealth-maximizing price discrimination, including fewer peak-related tariffs; relate price discrimination less closely to the demand and supply conditions applicable to each group

> of users; favor business relative to residential users; offer a smaller variety of output; change prices less frequently and in response to larger changes in economic determinants; adopt cost reducing innovations less readily; maintain managers in office longer; exhibit greater variation in rates of return.

Even though regulation of rates of return reduces the effectiveness of the profit incentives in the private sector, the studies summarized by De Alessi indicate that substantial differences still exist between the behavior of firms in the public and those in the private sectors.

Airline Service. In the United States, airline services are provided exclusively by the private sector so that no direct comparison can be made between the efficiency of private firms relative to public firms. Airline services in Australia are provided by the private carrier, Ansett Airline, and Trans Australian Airlines (TAA), the public carrier. Both airlines are regulated by the government and, as shown in the citation below, the regulatory process produces conditions which are ideal for public/private efficiency assessments.

> Airline fleets, while changing in composition over the years nevertheless show that in any given year the number and models of airplanes are virtually identical for each firm. The heavily traveled main routes are the same for each airline. Ansett and Trans Australian planes still arrive and leave airports at approximately the same time. Each enterprise provides essentially the same foods and services. The wage structure does not vary between companies. Even the privilege of carrying mail, formerly the responsibility of only one airline, is shared equally. . . their symbiotic relationship is so pervasive it even reaches into their separate restaurants in Tullamarine Airport with each having the same number of tables and chairs.
>
> The magnitude and qualitative nature of almost all of the important economic variables associated with the operation of the two airlines have either been held constant or allowed to change simultaneously for both enterprises by the government. Because of the remarkable similarity in the inputs of the firms, variations in performance may be attributed ultimately to differences in entrepreneurial organization. (Davies, 1977, pp. 224-25).

In Table 5, the three efficiency measures employed by Davies are reported for the period 1958-59 to 1973-74. As is evident, the private airline outperformed its public counterpart in every year regardless of the efficiency measure considered. The "bureaucratic rule of two" appears to apply only to the tons of freight and mail carried per employee, for the ratios of private to public output for both passengers per employee and revenue earned per employee are closer to one than to two. Given the rigorous regulation to which the private carrier was subjected by the government, it is not surprising that there is little difference between the two types of firms. Regulation was carried to extremes.

> For example, the government requires that when one airline purchases a new airplane the other must buy the very same make and model. Moreover, to prevent any competitive gains, the planes are introduced into service at the same time. When the two firms began DC-9 service the planes were not only introduced on the same day, but the same hour. (Davies, 1977, pp. 224-25, n. 10)

The above example is an indication of the extent of government regulation of Ansett. The fact that the private firm was able to outperform the public firm consistently over a period of sixteen years in spite of such severe regulation is, of itself, impressive testimony to the powerful incentives which exist in the private relative to the public sector.

The case studies outlined above clearly show that, without exception and in a wide variety of circumstances, private firms are far more efficient producers than either government firms or nonproprietary enterprises. These findings support the conclusion drawn from the models of utility maximization developed earlier that managerial incentives for efficiency are reduced in firms that do not seek profits. The model also suggests that there should be a bias toward labor as an input in bureaucratic

Table 5

Three Measures of Efficiency for
Public and Private Airlines in Australia,
1958-59 to 1973-74

Year	Tons of Freight & Mail Carried per Employee			Passengers Carried per Employee			Revenue Earned per Employee		
	Ansett[a]	TAA[b]	Ratio	Ansett	TAA	Ratio	Ansett	TAA	Ratio
1958-59	10.69	4.42	2.42	282	217	1.30	$ 7,172	$ 6,104	1.17
1959-60	10.77	4.57	2.36	309	259	1.19	7,758	7,016	1.11
1960-61	10.96	4.52	2.42	337	228	1.48	8,679	7,052	1.23
1961-62	10.84	4.64	2.34	331	246	1.35	8,425	7,367	1.14
1962-63	11.09	4.69	2.36	316	255	1.24	8,510	7,726	1.10
1963-64	11.06	4.83	2.29	324	274	1.18	9,071	8,093	1.12
1964-65	12.14	5.02	2.42	352	287	1.23	9,705	8,553	1.13
1965-66	11.08	4.88	2.27	354	294	1.20	10,479	9,072	1.16
1966-67	10.34	5.11	2.02	348	316	1.10	10,829	9,954	1.09
1967-68	9.57	5.41	1.77	363	337	1.08	12,080	11,033	1.09
1968-69	9.54	5.34	1.79	392	356	1.10	13,185	11,734	1.12
1969-70	9.35	5.80	1.61	414	390	1.06	14,118	13,146	1.07
1970-71	8.75	5.70	1.54	417	399	1.05	15,558	14,522	1.10
1971-72	8.82	5.63	1.57	437	414	1.06	17,280	15,644	1.10
1972-73	9.07	5.62	1.61	468	449	1.04	17,829	16,541	1.08
1973-74	10.02	6.06	1.65	532	496	1.07	21,461	19,183	1.12
Average	10.25	5.14	2.03	373	326	1.17	12,009	10,740	1.12

Source: Davies (1977, p. 226).

[a] Private airline. [b] Public airline.

operations, because the manager in the bureaucratic firm increases utility by increasing the number of subordinates. A similar bias should not exist in the private sector since profit maximization, which increases the manager's utility in this case, requires the selection of the most efficient combination of inputs. Although the empirical evidence on labor intensity in private vis-a-vis public enterprise is not as extensive as for cost comparisons, some significant findings have been reported.

Labor Intensity and Productivity. Orzechowski (1977) provided two cases in which the labor intensity in government is far greater than in private enterprise. First, he referenced a study by Spann, based on data for 56 Pennsylvania cities with populations between 24,000 and 400,000, which showed that public trash collection requires 97.3 percent more employees than does private collection, other factors held constant. Second, he performed an empirical investigation of the labor intensity of 62 public and private universities that indicated "the public colleges in a state would be expected to employ roughly 40% more labor than the private colleges for the same size capital stock" (p. 257). In addition, Clarkson (1972, pp. 381 ff) showed that nonproprietary hospitals are more labor intensive than proprietary institutions because personnel/bed, personnel expenses/total expenses, and personnel expenses/bed are all lower in proprietary than in nonproprietary facilities.

At the federal level of government, Orzechowski (p. 250) estimated the amount of capital per worker and reported that, in 1963, there was $50,232 of capital per federal employee; if the Department of Defense is excluded, however, capital per worker declines to $28,252. The private sector, according to Orzechowski, had a much lower level of capital per worker: $12,030 in manufacturing firms and $4,380 in service industries.

These data seem to indicate that the private sector is more rather than less labor intensive than the government sector at the federal level. Some caveats must be considered, however, before such a conclusion may be drawn.

One important issue is the size of the federal government work force. The U.S. Civil Service Commission (1976, p. 8) reported that the full-time civilian employment of the federal government was 2.56 million as of March 31, 1976. This apparently, is only the tip of the bureaucratic iceberg, for other labor inputs are also employed, e.g., consultants and contractors who often use government equipment and facilities. Estimates of these "indirect" labor inputs vary widely, but all indicate that the use of non-federal employees for government work is substantial. For example, Lambro (1979, p. 109) stated that

> A good estimate would be that from three to four million persons are paid by the federal government through consulting contracts, research grants and payments made for the wages of state and local government employees. Secretary Joseph Califano of HEW recently testified to the Senate Appropriations Committee that his Department pays the salaries of 980,217 persons who work for private think tanks, universities and state and local governments. This is in addition to the 144,256 "regular" HEW employees. The Department of Defense estimates that it pays the salaries of an additional 2,050,000 people through consulting contracts and the like. This figure does not include 2,049,000 military personnel who are also federal employees.

A study encompassing the major departments of the federal government in fiscal year 1978 was conducted by Blumenthal (1979, pp. 730-733) in order to determine the total number of individuals working indirectly for the federal government. The estimate was that 11 million were indirectly employed. If the labor input measure for the federal government included the indirect employment, capital per worker would be much lower.

A second issue relating to the relative labor intensity of the federal government and the private sector is that one must distinguish between the acquisition of capital and its use. In the private sector, capital is purchased to improve the productivity of labor in order to lower the cost of production. In the government sector, capital equipment may be purchased more as an ornament to enhance the prestige of the office which acquires the equipment than to increase efficiency. A case study is useful to illustrate this point. Between 1969 and 1977, the federal government expended in excess of $295.1 million in the rental and purchase of word processing equipment (GAO, 1979c, p. 34). If the same rate of increases in expenditures is maintained, annual expenditures will exceed $300 million by 1982. Basically, these machines are memory typewriters which facilitate making corrections and editing and are quite common in the private sector.

The introduction of this equipment to the federal work force would appear to offer enormous potential for cost savings and manpower reductions, for

> The federal government . . . employs over 171,000 secretaries, stenographers and typists. The annual salary outlay for these employees is over $1.5 billion. This secretarial force represents close to 11.5 percent of the total civilian white collar work force. Even slight increases in secretarial productivity would significantly lower the cost of this segment of the work force, thus making it particularly open to the application of word processing systems. (GAO, 1979c, p. 2).

The General Accounting Office undertook an audit of the use of this equipment in ten agencies and various field offices to determine their cost effectiveness, for there was no evidence of a decline in the level of secretarial or clerical staffing. GAO (1979c, pp. 20-21) found that "most agencies could neither demonstrate that they have increased their productivity nor that their word processing systems are, in fact, cost effective." Two particularly interesting cases were mentioned. The Internal Revenue

Service had installed, over a five-year period, a number of machines which cost $71,000 in annual rental; some were used as little as 1.5 hours per day. The U.S. Office of Education, apparently as a result of the GAO audit, planned to return 60 word processing systems because they were unnecessary. Other examples of the federal government's failure to make efficient use of capital equipment are available (See, for example, GAO, 1978a).

If, in fact, the federal government is highly capital intensive and the capital is appropriately used to maximize efficiency and reduce costs, it is surprising that federal debt collection and ship repair is far more costly than in the private sector. There is no evidence that the productivity of the federal sector has increased as rapidly as that of the private sector. According to Orzechowski (1977, pp. 250-251), "the federal government lags behind the manufacturing sector in registered productivity gain by a fairly significant amount even when it is realized that the productivity index for the federal government is probably a serious overestimate."

In sum, there is ample evidence that private firms which seek profits are more efficient producers of services than their governmental or nonproprietary counterparts. State and local governmental enterprises are more labor intensive than similar private firms and, although it appears that the federal government employs more capital per employee than the private sector, important questions remain about the appropriate measure of the federal labor input and even whether the capital is efficiently utilized. These findings provide empirical support consistent with the models of utility maximization set out earlier for managers of bureaucratic enterprises and for managers of profit-seeking firms.

IV. Conclusions and Policy Implications

Economic theory suggests that private rather than public enterprise should be the more efficient producer of goods and services since private firms may seek optimal scale of operation without the constraints imposed by political boundaries and since the market imposes a discipline on the manager in the private sector that is absent in the public sector. In contrast to the manager of the private firm whose utility is increased by profit maximization, the self-interest of the manager of a government bureau is enhanced by increasing the number of subordinates. These hypothesized differences between the public and the private enterprise were confirmed by a survey of case studies of private/public production of refuse collection, fire protection, debt collection, health care and hospital services, ship repair, electric power generation, and airline services. Without exception, the empirical findings indicate that the same level of output could be provided at substantially lower costs if the output were produced by the private rather than the public sector. The cost reductions would vary from activity to activity and, although the "bureaucratic rule of two" might not apply in every case, there is persuasive evidence that significant cost reductions could be achieved. Therefore, by passing these cost savings to the taxpayer in the form of lower taxes, it is possible to reduce taxes significantly without sacrificing public services.

Because of the nonexclusivity characteristic of public services, it is often taken for granted that public services should appropriately be both publicly financed and publicly produced. However, it is not necessary for public services to be either publicly financed or publicly produced in every case and there are important economic benefits to the taxpayer where public involvement is absent. For example, refuse collection and education can be produced very efficiently when individuals contract directly with competing private firms. There is no economic justification for public provision of these services, nor is there a need for a government bureaucracy to contract with a single private firm. The argument that economies of scale exist in trash collection which has been used to justify government contract with a single private firm is, as discussed earlier, largely specious. In any event, if scale economies do exist, they will be realized over time and do not need to be imposed by government fiat. Economic efficiency should be greatest when the competitive forces of the market are given full play.

There are, however, circumstances which justify public involvement in the private sector, such as the regulation of natural monopolies. Even when private firms are regulated which attenutates to some degree the profit incentive, the empirical evidence indicates that the regulated private entity is still considerably more efficient than the public-sector counterpart.

It is important to emphasize again that, in most of the case studies analyzed, no attempt was made to identify and correct for the opportunity costs of public rather than private production. Private firms pay taxes and licensing fees at the federal, state and local levels of government from which the public enterprise is exempt. Thus, the transfer of production from the public to the private sector would generate additional governmental revenues which are currently foregone. In addition, pension plans for government employees are rarely fully vested and represent a substantial future tax liability. If these considerations had been taken into account in the cost comparison studies, the private sector would have appeared even more efficient than the public sector.

The potential for cost reductions and tax savings by having private firms produce public services is not limited to the activities reviewed in this paper, but also apply to a wide range of functions now undertaken by governments at the local, state, and federal levels. Moreover, the economies achievable are real and not hypothetical, as shown by the two examples briefly described below.

For years, a six-member weather observation team has been maintained at Washington, D. C. National Airport by the National Weather Service, a part of the U.S. Department of Commerce. In 1978, the annual costs of this operation were $237,500. In July, 1979, the operation was contracted to a private firm that had underbid 27 others; this low bid was $67,000 per year. Even when government overhead costs are included and the salaries of two federal employees who will remain on the job are taken into account, the total annual costs of operation are only $152,000 --- a savings of $85,000 obtained by merely shifting four jobs from the public to the private sector.

In addition, there is an incentive for forecasting accuracy by the private firm. The National Weather Service "grades" forecasts on a monthly basis and if the forecast accuracy is below a contracted average, the firm is docked; if the forecasts are inadequate two months in succession, the contract can be judged in default (Valentine, 1979).

Substantial changes have been made in the operations of the city of San Francisco because of the effects of Proposition 13 (Prothro, 1979). The city's budget office, now under contract to a private firm, has announced that contractual services have been increased more than 25 percent over a year ago. In the budget office itself, a profit-sharing plan has been instituted for employees and the savings realized from private sector production could be substantial:

> In its 1978 report on Prop 13's fiscal impact on San Francisco, the budget office conservatively projected a possible $500,000 reduction in expenditures as a result of contracting public services such as golf course maintenance, provision of jail and hospital meals, certain electronic data processing applications, hospital inpatient services, and janitorial maintenance of city buildings.
>
> In fact, the savings could go much higher. Economies already realized from contractual labor range from $5000 for janitorial services at the Department of Health to $28,000 at the city's Academy of Sciences. And San Francisco General Hospital is contracting janitorial and nursing services to compensate for a phase-out of civil service positions worth $2 million a year, bringing the hospital's net budget down by $900,000.

In conclusion, the private-sector production of public services offers an excellent opportunity for tax reductions without sacrifice of services; the best of all possible worlds, at least in this case, can be achieved.

FOOTNOTES

[1] Some firms are, by government mandate, restricted geographically in their operations, e.g., the banking industry in some states is limited to unit banks or limited branching. The effects of such restrictions, however, can be and have been mitigated by the formation of holding companies.

[2] The Economics of "voting with the feet" was first developed by Charles M. Tiebout (1956) and is known as the "Tiebout hypothesis."

[3] A number of other investigators of bureaucratic behavior also assert that bureaucrats express a labor bias. For example, see Borcherding, Bush, and Spann (1977), Marris (1964), and Williamson (1964).

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Mr. ROUSH. Dr. Bennett's interest in the issue of Government competition has since resulted in his authorship of a book published this year and entitled, "Better Government at Half the Prices: Private Production of Public Services." It is a compelling examination of private versus public production of goods and services.

We have asked Dr. Bennett to accompany us here this morning because we believe that he may be able to provide you with much useful information in your examination of the issue.

With that, I would like Dr. Bennett to proceed.

Senator HAYAKAWA. Thank you, Mr. Roush.

Dr. Bennett, would you like to proceed?

Dr. BENNETT. Mr. Chairman, I appreciate this opportunity to express my views on the little publicized but critically important subject of the private production of public goods and services.

I believe this hearing could come at no more opportune time. The Congress is in the midst of a politically difficult budget reduction process which, while necessary, does not make the choices involved particularly easy.

However, despite the process and the ideological debate it entails, people of all political persuasions agree that the more efficient production of public goods and services can permit maintenance of essential public services at lower taxpayer cost. In fact, that is the bottom line of the private production of public services issue: Efficiency, which produces more services at less cost.

My statement today is basically the book, which Manuel Johnson and I wrote, entitled "Better Government at Half the Price: Private Production of Public Services." However, for obvious practical considerations, let me provide you with a copy of the book and briefly summarize its highlights. While I cannot possibly do it justice in the period allotted, I hope I can sufficiently pique your interest so that you will read it and, more importantly, act on its findings.

Essentially, there are two reasons why the private sector produces goods and services much more efficiently than the public sector: First, the differential incentive structure between the two sectors, and, second, the ability of the private sector, in contrast to the public sector, to conduct activities at the optimal scale of operation. Both are very important concepts.

With regard to incentives, we must recognize at the outset that when someone goes to work for Government, he is neither issued a halo nor a set of horns. That is to say, he is neither a saint or a sinner.

Like those in the private sector, individuals in Government respond to the carrots of reward and the sticks of punishment. However, while the people in the two sectors are no different, their incentive structures are vastly different.

Simply put, the bureaucratic incentive structure is designed to promote inefficiency whereas the private incentive structure is the reverse. Government employees are rewarded for ever increasing their budgets and for obtaining more individuals under their supervision. Private employees, and particularly small business owner/managers, are rewarded for cost cutting and for efficiency.

Government employees need not fear their organization will be driven from the marketplace whether they are efficient or not because of the legislatively mandated monopoly which they are given. Competition for the private sector is a constant concern, however. It remains almost impossible for a Government employee to be dismissed for incompetence or for lack of effort. The same is certainly not true in the private sector.

With such differences and incentives, it is little wonder that people in the two sectors respond differently and that the cost behavior in these two sectors are different.

Private firms, in contrast to public firms, are also free to adjust their scale of operations to produce the most goods and services for the lowest possible cost. Sometimes these economies of scale are reached at very large levels. Other times they are reached at much more modest levels. Governments cannot make such adjustments. They are required to provide similar services for all within the political jurisdiction.

Since political jurisdictions are as much an historical accident as they are an economic unit, and since political jurisdictions are fixed in size when the optimum scale of efficiency varies from service to service, governments are simply incapable of cost effectively competing with the private sector.

In fact, studies by many academic economists have produced what is known as the bureaucratic rule of two, that the removal of a service from the private sector to the public sector will at least double its unit cost of production.

The more efficient operation of the private sector is evidenced in the numerous examples cited in the book: garbage collection, fire protection, debt collection, ship repair, electric utilities generation, airline service, ambulance service, police service, education, and weather forecasting, in addition to the hundreds of functions as reported in the Small Business Administration study.

It is important to remember that these examples point out that not only can major cost savings accrue to the Federal Government, but also these savings can accrue to State and local governments. In fact, the surprise contained in the recently released GAO report on contracting out was that only $19 billion can be saved by the Federal Government. I certainly would have believed that this figure would have been far, far larger.

With the publicity given the so-called "Beltway Bandits," it would be inappropriate not to mention the specious arguments of those opposed to the private production of public goods or services. Let me briefly review them.

First, contracts lead to corruption. Here we must always remember it takes two to tango. A corrupt businessman needs a corrupt bureaucrat. Further, if the bureaucracy does its job, giving the appearance of propriety and reports all attempts of improper conduct, then there will be minimal problems. Corruption usually occurs only when contracting is sole source and not competitively bid.

Second, Government is more efficient. The whole book and all of the examples cited therein proves that that is not true.

Third, much of the contract work performed by the private sector is useless and wasteful. This argument has a definite ring of truth, but the question remains of who gives out the contracts? Who determines that the contract is necessary? Who approves the contracts? Certainly it is not the private sector. It is the bureaucrat who contracts for all of the work.

Fourth, the public employee is motivated by compassion. I would like to make two quick points here. If you have ever been caught in a bureaucratic maze, you soon will realize how compassionate bureaucrats are. Further, who is supervising these contracts to weed out those who are not performing well? It is the job of the public servant to insure that performance is done on all contracts.

Fifth and finally, Government employees are put out of work. That is true, but it is not necessarily bad. Allegations to the contrary, more efficient production of goods and services lead to much greater wealth and more jobs for all.

The book itself contains numerous spicy examples and horror stories of the kind that space does not permit here. While these increase reader interest and perhaps public appeal, I have presented the essential arguments.

I will be happy to answer any questions you might have, sir.

[The prepared statement of Dr. Bennett follows:]

STATEMENT OF

DR. JAMES T. BENNETT

PROFESSOR OF ECONMICS
GEORGE MASON UNIVERSITY

to the

The Subcommittee on Advocacy and the Future of Small
Business of the Senate Committee on Small Business

June 24, 1981

Mr. Chairman, I appreciate this opportunity to express my views on the little publicized but critically important subject of the private production of public goods and/or services. This hearing could come at no more opporture time. The Congress is in the midst of a politically difficult budget reduction process which, while necessary, doesn't make the choices involved particularly easy. However, despite the process and the ideological debate it entails people of all political persuasions agree that the more efficient production of public goods and/or services can permit maintenace of essential public services at a lower taxpayer cost. In fact, that's the bottom line of the private production of public services issue -- efficiency, more services at less cost.

My statement today, Senators, is basically the book Manual H. Johnson and I wrote, Better Government at Half the Price: Private Production of Public Services (Caroline House Publishers, Inc.: Ottawa, Ill.), 1981. However, for obvious practical considerations let me provide you a copy of the book, and briefly summarize its highlights. While I cannot possibly do it justice in the period allotted, I hope I can sufficiently pique your interest so that you will read it and more importantly act on its findings.

Essentially, there are two reasons why the private sector produces public goods and/or services more efficiently than the public sector: 1. the differential incentive structure of the two sectors, and 2. the ability of the private sector (in contrast to the public sector) to conduct activities at the optimal scale of operation. Both are important.

We must recognize at the outset that when someone goes to work in government he is neither issued a halo nor a set of horns. Like those in the private sector, individuals in government respond to the carrots of reward and the sticks of punishment. But while people in the two sectors are no different, their incentive structures are vastly different.

Simply put, the bureaucratic incentive structure is designed to promote inefficiency where the private incentive structure is the reverse. Government employees are rewarded for larger budgets and more people under their supervision. Private employees, and particularly small business owner/managers, are rewarded for cost-cutting efficiencies. Government employees need not fear their organization will be driven from the market place whatever their efficiency; competition for the private sector is a constant concern. It remains almost impossible for a government employee to be dismissed for incompetence or lack of effort; the same is not true in the private sector. With such differences in incentives, it is little wonder people in the two sectors respond differently.

Private firms are free to adjust their scale of operations to produce the most goods and/or services for the lowest cost. Sometimes these economies of scale are reached at massive levels; other times they are reached at modest levels. Governments cannot make such adjustments. They are required to provide similar services for all within their jurisdication. Since political jurisdictions are as much an historical accident as they are an economic unit, and since political jurisdictions are fixed in size when the optimum scale of efficiency varies from service to service, governments are simply incapable of cost-effectively competing with the private sector.

The more efficient operation of the private sector is evidenced in the numerous examples cited in the book: garbage collection, fire protection, debt collection, ship repair, electric utilities, airline service, ambulance service, police service, education, and weather forecasting plus the hundreds of functions as reported in the SBA study. It is important to remember that these examples point out that not only can major cost savings accrue to the Federal Government, but to the State and Local Government as well. In fact, the surprise contained in the recently released GAO report on contracting out was that only $19 billion can be saved by the Federal Government. I certainly would have thought the figure would have been larger.

With publicity given the so-called "Beltway Bandits," it would be inappropriate not to mention the specious arguments of those opposed to the private production of public goods and/or services. Let me briefly review them. First, contracts lead to corruption. Here we should always remember it takes "two to tango." A corrupt businessman needs a corrupt bureaucrat. Further, if the bureaucracy does its job (gives the appearance of propriety and reports all attempts of improper conduct), then there will be minimal problems. It all starts with the bureaucrat. Second, government is more efficient. The whole book proves that erroneous. Third, much of the contract work performed by the private sector is useless and wasteful. This has a ring of truth, but who gives out the contracts? Who determines the project is necessary? Who approves these boondoggles? Not the private sector. It is the bureaucrats who need all this work done. Fourth, the public employee is motivated by compassion. There are two quick points here: if you have ever been caught in a bureaucratic maze, you soon see how compassionate bureaucrats are when they shovel you to the next window. Further, who is supervising these contracts to weed out those who are not performing well? Fifth, government employees are

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put out of work. That's true, but it isn't necessarily bad. Allegations to the contrary, more efficient production of goods and services leads to greater wealth and more jobs for all.

The book itself contains numerous spicy examples and horror stories of the kind that space does not permit here. While these increase reader interest and public appeal, I have presented the essential argument.

I will be happy to answer any questions.

Senator HAYAKAWA. Thank you, Dr. Bennett. I look forward to reading your book. I know members of my staff have read it with great pleasure and have recommended it to me.

Dr. Bennett, what figure do you believe is correct if you believe that the GAO figure is too low?

Dr. BENNETT. That would be very difficult to estimate in total. There is so much public competition with the private sector. Literally tens of thousands of operations are done which could be done by the private sector I would guess it would be far, far higher if a thorough study of all of the activities undertaken by the Federal Government was done.

Senator HAYAKAWA. Mr. Nelson, do you have a figure for this?

Mr. NELSON. Let me just comment on what Dr. Bennett just said with an example of something that is not measurable, or at least we have not found a vehicle to measure it.

The airlines in this country give a commission to travel agents all over this country for booking air travel. I do not know what that commission is. I am not in that business. Yet all over this country we discovered and had testimony that the Government has people spending full-time booking air transportation for the bureaucrats. All that money spent in salaries, et cetera, for that booking time could be done by the travel agents, would not cost the Government a penny, and yet I do not know how to measure that because I do not know how many thousands of people there are around the country booking passage for the bureaucrats.

When he says it is difficult to measure, that is just one small example. There are thousands of instances like that where we cannot get hold of it. It is like a thunderstorm. I do not know when it is going to happen.

Senator HAYAKAWA. That is a very good example. Thank you very much.

Does anybody else want to comment on that?

[No response.]

Senator HAYAKAWA. In that case, Mr. Nelson, your testimony states that during the course of full hearings by the task group, many small business owners stated that they were economically threatened by Government competition. Would you highlight one or two of these cases for the subcommittee?

Mr. NELSON. I just highlighted one because there are many small travel agents. I guess Government competition appears in many ways, Mr. Chairman. This is a big way. Let me suggest to you, sir, that until the Government stops borrowing the money that we, the small business community, so desperately need so that the interest rates that we, small business, are paying today can get back to the level that we can afford to pay and make a profit and create more jobs in this country, that is one form of Government competition.

Right out here in Fairfax County—I believe it appears in Dr. Bennett's book—there was a study done of the garbage collection that is done by the county. The cost is four times what it would be if it were done by the private sector.

Government competition appears from the Government itself dictating how something shall be done. I give you an example again that appears in Dr. Bennett's book, bad debt collection. We just had an RFP hit the street this week, request for proposals for debt collection for the Department of Education. The Government created a situation in those RFP's whereby the small business community cannot bid. It will be completely precluded from bidding on that debt collection of $1.5 billion in student loans.

I suggest to you that the small business community can do equally as well a job, if not better, than the big business. We have a hands-on, day-to-day management.

There are many, many others, Mr. Chairman. I know that time is of essence here. I could talk about this subject for the next 4 days, but I will yield to my companions here.

Senator HAYAKAWA. Thank you, Mr. Nelson.

I want all four of you to feel free to chime in whenever you feel the need to add a comment to the statement of another panel member.

Mr. Nelson, does the task group that you chaired plan any additional meetings or hearings? Do you think that followup research or perhaps another full-fledged study is necessary or would prove useful?

Mr. NELSON. We presently have no further plans to proceed. I would strongly recommend to the Senator that he do whatever he can do in the Congress of the United States to cause this to happen. The people who are sitting at this table and the people who are going to testify yet this morning would be happy to again serve to further pursue the issue of Government competition. Our task was very carefully outlined to us by the Office of Advocacy and we went forth as best we could in the report that you have lying in front of you.

There are so many areas, Senator, such as the indirect competition issue, that need much exploring that we just did not have the time. I strongly recommend to you, sir, that you do what you can to further more study on this issue. We have but scratched the surface.

Senator HAYAKAWA. I understand that. There is a point when enough study has already been undertaken to take some action. Perhaps we can postpone further studies until we really desperately feel the need for it. At any rate, we already have enough information to merit action.

I would like to proceed with further questions for Mr. Hostetler.

Would you elaborate, Mr. Hostetler, on the inter-relationship of the Government, the independent nonprofit, and the taxpaying business sectors in our free enterprise system?

Mr. HOSTETLER. Mr. Chairman, that is really one of the most complex aspects of what the task group considered. Government, through its tax laws, through its grant laws, through mailing privileges, through a number of specific benefits which are provided only to nonprofit instrumentalities, puts them in a position in the marketplace where they are able to compete more effectively than taxpaying organizations.

In terms of thinking about further studies, we completely agree with your point. We would very much welcome action on the issue. We do not feel that studies would serve any further purpose.

However, in this area of indirect Government competition, our conclusion was that there was a need to educate, to inform, and to understand that problem much, much better. Perhaps as you hear further testimony and thought is given to these issues, that would be an area that deserves further examination by this committee or some body that you might identify.

Senator HAYAKAWA. Would you give me a couple of examples of what you mean by the independent nonprofit sector?

Mr. HOSTETLER. Mr. Chairman, under the tax laws, nonprofit research institutes, educational institutions, and charitable organizations are provided tax-exempt status. What has frequently happened is that these institutions have entered into what are just purely commercial activities.

In fact, I would like to defer to our chairman, Mr. Nelson, to describe a situation in Wisconsin with which I think he is intimately familiar involving the operation of a motel. It will take a moment, but I think it illustrates the point.

Mr. NELSON. There is a university in Wisconsin, a state supported school, a large school with an enrollment in excess of 30,000 students.

Senator HAYAKAWA. To which university do you refer?

Mr. NELSON. I refer to the University of Wisconsin in Madison.

There are two motels in close proximity to this particular university. They were a thriving business. Some years ago, the university decided to build their own motel right across the street or in the proximity of the campus and so did build this. Of course, this is with tax dollars. They are tax exempt.

All of a sudden, the two motels with some 350 units adjacent to the university campus are having trouble staying in business. The fact of the matter is they have both been sold in the last 2 years, I understand.

That is just an example of a Government-supported tax free institution competing with the fellow who is providing beds and pillows to those people who come to visit the University of Wisconsin.

Mr. HOSTETLER. Just to conclude this point, Mr. Chairman, we have no antagonism toward the nonprofit community. We think it serves an extremely important purpose in our society.

We would very much wish that educational institutions and nonprofit organizations would dedicate themselves to fundamental research, to education, and to those missions that are vitally important if the country is going to compete successfully in terms of new technology and so forth.

We are simply trying to reestablish the proper roles which we think make each institution, whether the small business sector, the university community, or the nonprofit sector generally, function most efficiently. What we have found is that these distinctions increasingly are blurred as there are more and more commercial activities conducted by Government or Government-sponsored instrumentalities meant for different purposes.

Senator HAYAKAWA I am interested in the story from Mr. Nelson tells about motels built by the University of Wisconsin. It reminds me of something I had not thought about for years.

Forty years ago I was a student there. It was before the outbreak of World War II. I remember a little restaurant called Shorty's. It was called Shorty's because the owner was so very tall. I remember Shorty leaning across the counter, pounding the counter and saying, "I contributed $500 toward that student union. What do they do? They open up dining rooms and cafeterias and run me out of business."

Mr. NELSON. It has not stopped, Mr. Chairman.

Senator HAYAKAWA. I am sure it has not.

Mr. Roush, what priority does NFIB attach to the issue of Government competition?

Mr. ROUSH. Mr. Chairman, the half million small business members of NFIB place extremely high priority on the issue. Because of numerous other things going on, and because of the scope of the problem, it is an issue that we have not in the past had a chance to focus on as much as we would have liked. It is something that we intend to spend a lot of time and energy on during this Congress to bring out cases from our members across the country to illustrate the problem with real life examples. It has a very high priority, Mr. Chairman.

Senator HAYAKAWA. Thank you.

I will pose this question open for all of you. It was you, Mr. Hostetler, who used the term of "better Government at less cost." Can all of you contribute to clarification of that term?

Dr. Bennett.

Dr. BENNETT. The idea is that if we can produce the same level of services at much lower cost, I think we can consider this to be better Government. The idea is that by having Government produce goods and services, for example to generate electricity, collect trash, or provide services in competition with the private sector, we can do it far more cheaply and with far fewer tax dollars if the private sector does it than the public sector. To me, that is better Government.

Senator HAYAKAWA. In your book, sir, do you have as one of your examples the comparative costs of garbage collection in New York City as opposed to garbage collection in San Francisco?

Dr. BENNETT. No. We did deal with garbage collection. As a matter of fact, that is what got me started on the book. I moved in Fairfax County from an area in which the county picked up my trash and where I had lived for 8 years to a new area. I asked the previous owner when the county trash truck came by. He informed me there was no county trash truck and I would have to call one of the roughly five private services that went up and down the street.

I was concerned about what this might cost me. I started checking around on the cost. I found that I was getting service twice a week from a private firm for half of the cost that I was getting from the county for once a week service.

Others have done studies of trash collection as well. There are a number of studies listed here, but there is nothing that I recall specifically on San Francisco.

Senator HAYAKAWA. I just remember the San Francisco/New York example because in San Francisco, garbage collection is contracted out to the private sector. In New York, garbage collection is a municipal function. Apparently the costs in New York are astronomical compared to those in San Francisco. That study was made some years ago and I have forgotten some of the details.

Dr. BENNETT. Even then, probably all the costs in the New York study were not even included. For example, the costs of pensions are rarely included in these cost comparisons.

Senator HAYAKAWA. That is true. When you do have these services performed by the Government itself, you have to take on the whole problem of pensions, disability pay, and everything else.

Dr. BENNETT. Yes, sir.

Senator HAYAKAWA. These are costs that are not factored in.

Dr. BENNETT. That is right. However, in the private sector, the taxpayer has no liability whatever to those employees beyond the liability that the company has to the employees.

Senator HAYAKAWA. That simplifies the Government itself. Never mind the cost. The simplification itself is a contribution.

Dr. BENNETT. Absolutely.

Senator HAYAKAWA. I think we can submit the rest of the questions for the record. All witnesses have agreed to answer further questions in writing.

[Subsequent information was received and follows:]

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 30, 1981

Mr. Dale Nelson, President
BMS Services, Inc.
304 15th Street
Des Moines, Iowa 50309

Dear Mr. Nelson:

I personally would like to thank you for testifying before the Subcommittee on Advocacy and the Future of Small Business on Wednesday, June 24, 1981. I believe that our initial investigation into the extent of government competition with small business was both enlightening and thought-provoking. I am looking forward to further, in-depth hearings on this important issue.

As I mentioned during the hearing, I did not have the opportunity to pose all of the questions I had hoped to ask. Accordingly, I have enclosed additional questions and would very much appreciate your written response for the official hearing record. Any additional comments you have for the record are welcome also.

If you have any questions about these materials, please do not hesitate to call Kimberly Elliott with the Small Business Committee at (202) 224-3840 or Grace Hussie on my personal staff at (202) 224-3841.

Again, thank you for your participation in what I believe was a very productive hearing.

Sincerely,

S. I. HAYAKAWA
Chairman
Subcommittee on Advocacy and
the Future of Small Business

QUESTIONS FOR MR. NELSON

1. Would you summarize the benefits of increased competition for the record?

A. The Commission on Government Procurement in its 1972 report noted that

> Competition is not a procurement technique. It is a phenomenon of the marketplace, and the extent to which it exists in any given marketplace ordinarily is not influenced by the method of procurement employed. Competition is the effort of sellers, acting independently of each other and offering products or services that are reasonably close substitutes for those offered by other sellers, to secure the business of the buyer by proposing the most attractive contract terms. (at Vol.1, p. 12)

Effective and reasonable competition in providing goods and services to the Federal government assures quality, fair prices and timeliness of performance.

2. Why, in your opinion, has the government been so reluctant to enforce A-76?

A. The primary reason for the failure of the Federal government to enforce OMB Circular A-76 is that A-76 has not been perceived as a national policy with full executive and legislative branch approval and support. This was the conclusion of the General Accounting Office report, "Development of a National Make-or-Buy Strategy Progress and Problems" (PSAO-

78-118) September 25, 1978. Much of the reluctance to enforce A-76 results from opposition from major Federal employee organizations, despite the fact that Federal employees can be and are protected from displacement. A recent example is the unsuccessful lawsuit by American Federation of Government Employees to prevent contracting-out of custodial services at Randolph Air Force Base, Texas, American Federation of Government Employees, AFL-CIO et al. v. Stetson, et al. (9th Cir., March 25, 1981). I also suspect that there is an inherent reservation on the part of senior Federal managers to reduce the number of activities under their direct control.

The GAO found that, as a result of the lack of perception that A-76 represents a strong national policy, A-76 is left outside the main agency decision-making process; it has not received management emphasis; there has been a lack of adequate agency instructions; and, required reviews were not diligently conducted. Of particular significance, the General Service Administration has given A-76 virtually no attention at all. GSA has not promulgated regulations governing contracting-out for the civilian agencies, and implementation for GSA activities has been non-existent.

In a letter to GSA dated April 8, 1981, OMB Deputy Director Edwin L. Harper noted that implementation at GSA has been "in a vacuum for almost two years."

Only through efforts such as Senate Joint Resolution 93, can the inertia which impedes enforcement of A-76 be overcome.

3. As a small business owner, do you have any personal experience with Government competition?

A. In my small business activities, I have performed virtually no work for the Federal government. The Federal procurement process as it now exists makes it difficult for my firm to seek Federal business. In my capacity as Chairman of the SBA Task Group on the Impact of Government Competition on Small Business, I learned about literally hundreds of cases of government competing with small business.

4. Do you believe that any legislation in addition to my resolution will be needed?

A. Yes. There are a large number of laws which encourage and even require Government competition with the private sector. In the area of direct competition, Section 502 of the Department of Defense

Authorization Act, 1981, places restrictions on the ability of DOD to contract out. Other restrictive laws were reviewed in the GAO report discussed above, including the Economy Act of 1932, 31 U.S.C. § 686(a), the Arsenal Statute, 10 U.S.C. §§ 4532, 9532; and the Federal Printing Statute, 44 U.S.C. § 501.

Of equal or greater importance are the tax, grant and procurement laws which foster indirect competition by governmental and non-profit organizations.

The Office of Federal Procurement Policy will submit proposed legislation for the new Federal Procurement System (FPS) in October, 1981. Senator Danforth's Subcommittee on Federal Expenditures, Research and Rules, Senate Committee on Governmental Affairs, has held hearings on FPS and plans additional hearings prior to submission by OFPP. It is essential that the FPS legislation strongly and unequivocably establish the policy of reliance on the private sector.

5. You were a delegate to the White House Conference on Small Business. Did the delegates view government competition as a serious threat to small business?

A. Yes. The sentiment expressed by small businessmen was high. Three of the recommendations of the White House Conference on Small Business addressed government competition, two from the viewpoint of Federal procurement and one in the area of innovation and technology:

> The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities. Small business generally - 50% which shall include the following: minority-owned businesses 15%, business owned by women 10%.
>
> The Federal Government should contract out supplies and services to private industry (particularly small and minority business) and should not compete with the private sector either through the use of its own personnel or through non-profit organizations such as the Federal Research Centers, educational institutions or other non-profit entities.
>
> Existing Federal research and development procurement, assistance, and tax laws and policies must be modified and new laws enacted to: 1) eliminate unfair advantages enjoyed by governmental agencies, non-profit organizations and educational institutions which compete with innovative small business in providing goods and services and 2) mandate statutorily a national policy of reliance on small business, 3) prevent the Federal government from disseminating proprietary information, 4) prevent the Federal government, through the use of its own personnel including Federal Research Centers, from competing with small business.

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 30, 1981

James Hostetler, Esq.
Chapman, Duff and Paul
1730 Pennsylvania Avenue, N.W.
Washington, D. C. 20006

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Sincerely,

S. I. HAYAKAWA
Chairman
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the Future of Small Business

QUESTIONS FOR MR. HOSTETLER

1. Recently, numerous caes of fraud and abuse resulting from consulting contracts have been documented. In your opinion, does the competitive bidding system lend itself to fraud and abuse?

A. The competitive bidding system not only insures that the Federal government obtains goods and services at the lowest reasonable prices, but it contributes to minimizing possible fraud, abuse and waste in the acquisition process.

I would, however, disagree with the assumption upon which your question is based. The General Accounting Office recently completed a massive review of actual or suspected fraud involving Federal funds. Fraud in Government Programs -- How Extensive Is It? -- How Can It Be Controlled? (AFMD-81-57), May 7, 1981. In a statistical sampling of 5,000 cases, GAO found that about 1 percent of the fraud involved procurement and disposal of surplus property. Abuse and waste is present in connection with consulting contracts, but probably no more or less so than with other procurements. Abuse and waste does not result from the procurement system, but, in large part, from the inability of the Federal government to maintain satisfactory in-house capabilities.

The nation has experienced a serious decline in the competence and capacity of Federal managerial leadership. The Civil Service Reform Act of 1978 has not improved the morale, or slowed the exodus of senior Federal career executives. The problem of pay comparability for senior government managers has not only defied solutions; it has grown far worse. In these circumstances, the capacity of the Federal government to make the most effective use of expertise in the private sector has suffered greatly -- Federal agencies cannot perform rigorous analysis of policy and technical alternatives presented by contractors to the extent necessary. Furthermore, the Federal procurement workforce is woefully understaffed and inadequately trained. The former director of procurement and contract management for the Department of Energy, B.Gen. Michael Tashjian, USAF (Ret.), detailed problems in the staffing and competence of procurement officials in the December, 1980 issue of _Contract Management_.

While competition in Federal procurement minimizes waste and abuse, there are many situations in which non-competitive (sole source) procurements are appropriate. For example, as pointed out in recent testimony by Robert F. Trimble, until recently Acting Deputy Under Secretary of Defense for Research and Engineering (Acquisition Policy), for continuing needs that build upon previous support service efforts, it would simply not be cost effective to solicit anew at frequent intervals. Establishing the necessary technical competence and capability by a new source is often too costly and too risky for the Government. Testimony before the Subcommittee on Defense of the Committee on Appropriations, United States House of Representatives, 97th Cong., 1st Sess. (June 23, 1981).

2. You cite several recent appropriations-authorization bills that limit contracting opportunities for the private sector. Why is this happening when it clearly runs counter to national policy?

A. Unfortunately, we do not have a strong, widely adopted and enforced national policy of maximum reliance on the private sector. Passage of S.J.Res. 93 would go a long way toward establishing such a policy with the proper emphasis.

In the absence of a strong national policy, it is inevitable that individual members of Congress will seek exceptions, including limitations on appropriations for certain procurements, based on sympathy with the dilemma faced by constituent public employees. In the midst of a general cut-back in appropriations for the operation of Federal agencies, public employees face the prospect of their positions being transferred to the private sector. Fortunately, the current Administration is sensitive to this problem. Donald Sowle, Administrator of Federal Procurement Policy, testified before your Subcommittee on June 24, 1981 concerning the Administration's policies of giving priority consideration for placement in other positions to those displaced by contracting-out decisions and of requiring contractors to give affected Federal employees the right of first refusal for jobs under a contract.

3. Could you explain the relationship between consulting services and A-76? Do you have any comments on the difference between a consultant's advice and his performance of a government function?

A. OMB Circular A-76, the primary statement of the policy of reliance on the private sector for necessary goods and services, does not apply to consulting services of a purely advisory nature relating to agency administration and management and program management. This exception from OMB Circular A-76 is without a sound factual or policy basis. Certainly, the same A-76 cost comparison procedures applicable to the acquisition of many goods and services are not appropriate for consulting services to other services such as research and development. However, research and development acquisitions are subject to OMB Circular A-76, although supplemental guidance is necessary. Consulting services should be treated similarly.

Consultants do not "perform" governmental functions in the sense of exercising governmental authority. They do, however, provide essential, objective assistance to those performing governmental functions. For example, it is hard to conceive of effective Federal defense functions without privately-provided operating and technical support. The "essential" role of consulting services in carrying out the Defense role was explained by Robert Trimble in his testimony referred to in my answer to Question 1.

When agencies cannot attract, retain, motivate and reward required scientific, technical and professional personnel, they often cannot adequately analyze the recommendations of consultants or develop other options. Thus, a focus on performance of governmental functions by consultants is not a useful exercise. A more important issue concerns the extent to which the agencies have the core capability necessary to make best use of the consulting services.

4. As a result of present federal practices in competing with its citizens, is it your impression that many qualified small businesses simply avoid the federal market?

A. Clearly yes. Small businesses constitute 95 percent of all the private enterprises in America, employ 58 percent of the private non-agricultural adult workforce and produce 43 percent of the gross national product. Office of Advocacy, U.S. Small Business Administration, The Study of Small Business, June 3, 1977, p. 13. Small businesses are the leaders in innovation. For example, since World War II, firms with 100 or fewer employees produced over 24 percent of "the most significant new industrial products and processes." Office of Advocacy, U.S. Small Business Administration, Small Business and Innovation (Washington: SBA, 1979). Yet, less than 4 percent of Federal

R&D dollars go to small firms, just 31 companies take more than 60% of Federal R&D dollars. A recent General Accounting Office report recounts the discouragement of small businesses who seek to enter the Federal market. Large Businesses Dominated Awards Made Under DOE's Alternative Fuels Program (EMD-81-86), May 15, 1981, p. 10.

While these statistics are powerful indirect evidence that many small businesses avoid the Federal market, based on numerous informal discussions with small private sector firms, I assure you that this is the case.

5. In private industry, what has the experience of larger companies been in utilizing outside sources of services and expertise? Is the government, as the country's biggest business, utilizing sound management and procurement practices?

A. In view of the extent to which private industry uses outside sources of expertise, it is clear that its experience has been overwhelmingly positive. For example, a recent article in Business Week, May 21, 1979, reviewed the management consulting industry, which provides services directed toward improving the managerial, operating and economic performance of organizations. Business Week concluded that the growing complexity of business operations has caused a spectacular growth in the use of management consulting specialists in all areas of corporate activities. It is unfortunate that the institution with the most complex and sophisticated operations, the Federal government, is going in the opposite direction. For example, in the recently passed Omnibus Budget Reconciliation Act of 1981, appropriations for the acquisition of "consultant services, management and professional services, and special studies and analysis" were targeted for a $500 million reduction in FY 1982. To limit so radically the ability of the Federal government to draw upon the experience and expertise in the private sector, when increasing the efficiency and effectiveness of Federal activities is essential, demonstrates a lack of sound fiscal management.

6. There is much discussion about the government's difficulty in assembling talent whether in-house or outside to pursue national needs. Do you feel that attacks on contractors and consultants have been justified or has attention been diverted from formulating constructive improvements in the process of procuring capabilities to assist the government?

A. It is always appropriate for the Congress and Executive branch to inquire into actual or possible abuses in government procurement. Unfortunately, widespread attention to anecdotal accounts of abuses has not resulted in necessary improvements to management of the acquisition system. Rather, it has given rise to severe impediments to the ability of the Federal government to draw upon the expertise and experience of private industry at a time when those resources are most needed.

We are in the midst of a crisis in the government's capacity to perform its role. Significant numbers of senior Federal executives are leaving public service and it is increasingly difficult to acquire first rate talent for government service from the business and academic worlds. At the same time, unprecedented restrictions have been imposed on the ability of Federal managers to contract with the private sector. I have already cited the Omnibus Budget Reconciliation Act of 1981 which reduced FY 1982 appropriations for "consultant services, management and professional services, and special studies and analyses" by $500 million; the Department of Defense is faced with substantive and procedural restrictions on its ability to convert commercial and industrial functions from in-house performance to performance by the private sector (Section 502 of the Defense Authorization Act, 1981, Pub.L. No. 96-342); and a maze of procedural requirements has been imposed on agencies seeking to acquire private sector consulting services (*e.g.*, OMB Memorandum to Selected Departments and Agencies, Management Control of Consulting Service Contracts and Improvement of Agency Procurement Practices, July 2, 1980).

At a time when economies in the expenditure of public funds are most needed, the Federal government must develop sound, competent management practices and must be able to make use of the immense resources in American private industry. There is no question but that attention to these tasks has been diverted.

Senator HAYAKAWA. At this point, let me thank all four of you. Thank you for your testimony.

We will proceed to the next stage of this hearing. I now have the pleasure of introducing the second panel: Mr. Edward Meell, president, Media Management Services of Yardley, Pa.; Dr. Earl Hess, president of Lancaster Laboratories of Lancaster, Pa.; and Mr. George Ostrowski, president of Business Management Research Associates of Arlington, Va.

Good morning, gentlemen. I am happy to have you proceed with your testimony. Would you like to start, Mr. Meell?

STATEMENT OF EDWARD J. MEELL, PRESIDENT, MEDIA MANAGEMENT SERVICES, INC., YARDLEY, PA.

Mr. MEELL. Thank you, Mr. Chairman.

Thank you for inviting us here today and for holding these hearings. They are long overdue, believe me.

With your permission, I would like to have my written testimony entered into the record as presented, and to add to that testimony a chronology of Federal Government audiovisual policy since 1975.

Senator HAYAKAWA. That will appear following your oral testimony.

Mr. MEELL. Thank you.

In the few moments that are allotted to me, I would like to highlight a few things and add a few thoughts in my remarks this morning.

You are embarking on a long journey and this is an important first step. Permit me to help put some things in perspective as it relates to the audiovisual industry.

First, as to the industry itself, it is mostly small companies. Ninety-five percent of the companies in the industry gross less than $5 million a year in revenue.

Second, they finance, produce, and distribute media to schools, libraries, and business and industrial concerns in this country.

Third, they have been doing this for over 50 years.

Last, the entire industry annual sales is in the neighborhood of $300 to $400 million a year. That figure is important because I will refer back to it.

These small businesses are fighting a losing battle with competition, a competition that is multifaceted. They are of course competing with their friendly competitors in the marketplace. That is as it should be.

They are also competing for dollars in dwindling school budgets. They are competing with gas, oil, teacher salaries, pension funds, schoolbuses, and so forth. They are competing with inflation. They are competing with the U.S. Government for money in the money market.

However, most importantly, they are competing with the U.S. Government audiovisual mill. The U.S. Government spends, conservatively, in the neighborhood of $500 million a year for audiovisual goods and services. I think that figure is probably double or triple that amount. Consider again the first figure I gave you of $300 to $400 million for the entire audiovisual industry. The Government spends more than the entire industry combined.

These services provided by the U.S. Government are for in-house production of audiovisual materials: Films, videotapes, sound filmstrips, and other materials. It also includes making grants to State and local governments and to nonprofit organizations to produce audiovisual programs.

For example, in this morning's Washington Post, the Assistant Deputy Director of OMB admits that the Federal Government does not know how much it spends on films. It does not know. It cannot come up with a figure. That is frightening.

It is not bad enough that the Federal Government produces these things. Many of these programs duplicate what the private sector is already producing. That is disturbing.

Even more disturbing is that they have now decided that nothing is too good for the U.S. citizen. They must also distribute these programs directly to the citizens, bypassing the private distribution sector.

Consider two cases. The National Audiovisual Center has 12,000 titles in direct distribution to schools, organizations, industries, and libraries of this country. They do it with low-cost manufacturing and low-cost mailing. They go to all the same conventions as the private sector and they compete directly in the booth next to you. They sell their programs at half the price and in some cases way less than half the price than a for-profit company would have to sell the same programs. The main difference is they pay no taxes on that income.

A second example is a national diffusion network. The U.S. Government has spent somewhere in the neighborhood of $66 million to develop materials for teacher education. The national diffusion network spends $10 million a year to diffuse this material. I think that means distribution, but they call it diffusion to try and mask it, I think.

On top of that, the local districts use title 4(c) and title 1 money out of ESEA to supplement that. Therefore, we have a nice tidy circle. The Government produces the material, the Government distributes it, and then the Government helps local districts supplement it. The private sector is completely shut out of that.

There are others. PBS video services distributes materials in competition. The Agency for Instructional Television produces instructional television whereby the States contribute Federal money to AIT to develop programs and distribute those on video cassettes, films, and video discs to the schools.

The distribution thing is frightening. It smacks of a whole lot of things that we really do not like to hear in this country.

If that is not bad enough, consider three other things. The Congress is now considering block grants for education. Part of the administration's rationale for block grants is that the district can then produce their own materials locally. I would submit that they will probably also disseminate that. Dallas is disseminating materials all over the country. Montclair, N.J., schools are disseminating sex education materials and programs all over the country. That is frightening. The Federal Government is financing or helping to finance that.

Second, Children's Television Workshop and the National Geographic are partially supported by the Federal Government through tax laws, through research grants, and so forth to produce materials that the private sector cannot afford to produce. Then they are distributing them in direct competition with the private sector.

Universities are now producing sound filmstrips for elementary schools. I do not know why universities should produce sound filmstrips for elementary schools.

I could go on with more and more examples. Direct competition is serious, but just as serious is the example that the U.S. Government is setting. They have now shown the way to State and local governments and to nonprofit organizations on how to do it, how to get into the public controlling the total education materials market.

It is time to reverse this trend and get the U.S. Government out of movies. Therefore, I strongly endorse and support your efforts through Senate Joint Resolution 93 and urge you to pursue this effort. I would be willing to help in any way possible and to answer any questions that you or any members of the subcommittee would have.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Meell follows:]

STATEMENT OF
EDWARD J. MEELL
PRESIDENT
MEDIA MANAGEMENT SERVICES, INC.
BEFORE THE
SUBCOMMITTEE ON ADVOCACY AND
THE FUTURE OF SMALL BUSINESS
OF THE
U.S. SENATE COMMITTEE ON SMALL BUSINESS

CONCERNING
U.S. GOVERNMENT COMPETITION WITH
SMALL BUSINESS IN THE AREA OF
AUDIOVISUAL PRODUCTION/DISTRIBUTION

MEDIA MANAGEMENT SERVICES, INC.
10 NORTH MAIN STREET SUITE 301
YARDLEY, PA 19067

JUNE 24, 1981

Mr. Chairman, I am Edward J. Meell, President, Media Management Services, Inc. of Yardley, Pennsylvania. My company is a small business employing seven (7) people and serving the audiovisual industry as a management consultant. I've been engaged in the use, production and distribution of audiovisual materials for over twenty years as a teacher, producer, distributor and consultant.

Without wishing to minimize the fine work done by Representative Barry Goldwater, Jr., and his efforts over the years to make people aware of "Hollywood on the Potomac" ... a title picked up and further popularized by the CBS 60 MINUTES segment on government film production and distribution ... I would submit that the theatrical producers in Hollywood aren't the only ones who have to be concerned by all the government audiovisual programs ... 16mm films, videotape, and sound filmstrips ... produced by virtually every agency in the Federal Government; the many small film and multimedia producers and distributors across this land also suffer from this government competition. As I shall point out, the competition is serious and spreading to other segments of our economy.

The audiovisual industry in the U.S. is an industry of small businesses; many of them "mom and pop" operations. It's a cottage industry that has developed over the past fifty years or so to serve the schools, colleges, libraries and businesses of this land. Even those companies that are divisions of larger companies rarely gross over $5 million a year in revenues. 95% of them gross less than this. It's an industry of high investment and small unit sales which are being eroded by inflation, cuts in Federal funding, cuts in local school budgets and increasingly in a number of ways by competition from government agencies at all levels as well as non-profit organizations whose favored treatment by the Federal Government creates a competitive advantage for them with tax-paying small businesses. Some facts illustrate the problem:

1. An April, 1978, study estimated that the Department of Defense spends in the neighborhood of $350,000,000 per year on products, services, equipment and salaries to produce audiovisual programs. For FY 1976, DOD reported to OMB that it produced 1,141 motion pictures; 3,560 separate television titles; and 3,412 multimedia presentations.
2. In FY 76, 18 major civilian agencies reported production to OMB of 1,215 motion pictures; 1,870 television titles and 1,753 multimedia presentations.
3. Almost every agency has videotape capability and many have film equipment; some have libraries of films which they distribute to other agencies and to the public.
4. One agency, the Department of Health and Human Services, recently produced a film and is now paying to have it distributed free to the schools. It contracted out to a non-profit company for production and to a for-profit company for distribution. This is a step in the right direction but it refused to consider competitive bidding for distribution by the private sector; distribution

that would not only have reached more people but returned funds to the Federal Treasury in the form of royalties and taxes.

5. Another agency, the Department of Education, regularly contracts out for production but then tries to avoid contracting out for distribution. Rather than let private companies bid on distribution, they prefer to let the National Audiovisual Center "put the series in the catalogue." After all, "what would happen to the royalty the companies pay back?" Why, it would go into the general fund and "that wouldn't do our agency any good," or so I've been told by employees of the Department of Education.

In short, it's estimated that the Federal Government spends in excess of $500,000,000 per year on audiovisual production. The entire private sector audiovisual industry is $300,000,000. While some of this government production is contracted out, a good portion of it is produced in-house, produced by field offices, or is produced by grants to other public agencies such as colleges, schools, state agencies, non-profit organizations, and organizations such as the Corporation for Public Broadcasting and PBS stations.

The production aspect of the problem is only one side of the coin. The other side of the coin is audiovisual distribution. Here again the U.S. Government directly or indirectly competes with the private sector. Consider the following situations:

1. The National Audiovisual Center (NAC) a branch of the

General Services Administration distributes over 12,000 government audiovisual titles. It distributes them at slightly over laboratory cost and has the further advantage of low cost printing and mailing privileges. Their prices are so low, no for-profit company can compete with them.

2. Most agencies, rather than try to find private contract distributors, simply place completed audiovisual programs with NAC. It's the easy way out and avoids the necessity of dealing with "business" which their decidely anti-business bias causes them to consider as something like the plague. One notable exception to this is the Office of Special Education, Department of Education, which actually seeks private, for-profit distributors for its programs through the Market Linkage Project. This move should be applauded and supported.
3. Even though NAC was set up to be the main library for government produced programs for public communication and internal management information and training, many agencies still maintain their own libraries for circulation ... or as in the case of Health and Human Services, pays someone for a service that could be contracted out, all the expenses paid for by the private sector thereby helping employment, and return some money to the general fund via taxes and royalties.

The Federal Government, whether it likes to admit it or not, is in the business of producing, packaging and disseminating audiovisual instructional materials. In national security areas, this might make sense, but it makes no sense in the case of 70-80% of the audiovisual programs produced or distributed. Most agencies, including NAC, seem to be unaware of Circular A-76; or, worse yet, actually ignore it.

It's bad enough that the Federal Government produces and distributes programs itself in direct competition with the private sector. Unfortunately it doesn't stop there.

The Federal Government subsidizes and encourages unfair competition with the private sector through:

1. Granting non-profit status to many "educational institutions" who produce and sell audiovisual programs and market them by direct, low-cost mail. The Internal Revenue Service, by its own admission only audits about 10% of the non-profits for unrelated business income.
2. Making grants and awarding contracts to educational institutions. Generally, private sector concerns may not compete for government grants. Many of these grants are for research and production of audiovisual programs ... which are then sold by the non-profits but on which no tax is paid. In fact, many government agencies would rather make a grant than award a contract because it avoids having to deal with the private sector.

Consider a few other cases of direct government competition:

1. Children's Television Workshop has received millions of dollars in development money over the years which has

been used to produce programs now sold through their profit-making subsidiaries in direct competition with small businesses. These small businesses cannot compete with the investment needed to make programs of that quality. CTW wouldn't have done it on their own either.

2. The National Geographic, another non-profit organization that competes directly with for-profit companies through their own for-profit companies. What's the competition? The for-profit subsidiary of National Geographic has the advantage of high quality programs developed in part by research underwritten by the U.S. Government or funded by its non-profit parent.
3. Educational Institutions such as The University of Texas, Austin; California State Poly., San Luis Obispo; Ohio State develop and aggressively market programs while advertising their allegedly lower costs resulting from non-profit status. See the attachments for samples of their ads.

And if things haven't gone far enough, the front page of June 12th NEW YORK TIMES brings us the story of the plans of the Montclair, New Jersey, public school system to:

1. Expand the data processing center and pay someone to sell its services to 31 surrounding districts.
2. Publish books and pamphlets on education topics, print them in the school shop and sell them.
3. Bid for Federal Government contracts on military and sex education. The Federal Government has set a fine

> example of how to do it. We all admire initiative and entrepreneurship. But shouldn't it be on a fair basis? If schools like Montclair ... and Dallas ... and Dade County ... are going into the publishing and audiovisual business just like the Federal Government, shouldn't it be as for-profit organizations who compete on equal footing and also pay taxes on their revenue? Or, has the Federal Government set in motion a process whereby the entire educational system and all the materials used in it are dominated by public agencies? If that is the case, how long will it be before there are no private publishers and producers and we have an educational system very similar to that found in a totalitarian state?

The moratorium announced by the Administration was fine and we support it, but it didn't apply to non-profit organizations! Further, the educational bloc grant proposals currently being rushed through Congress without careful deliberation as to their impact actually will encourage the Montclairs of this world to make ... and probably sell ... instructional materials in direct competition with small businesses.

In the last several years, many small, tax-paying audiovisual publishers have lost substantial business or gone out of business because of the poor economic climate and because of unfair competition from the U.S. Government, state and local agencies or the non-profit private and public sector. Government produced materials often duplicate existing materials and constitute a considerable waste of tax dollars. This should not be encouraged. In fact, it should be strongly denounced and discouraged by:

1. Mandating a policy of reliance on the private sector as recommended by Senator Hayakawa's resolution on Circular A-76 and making it applicable to government agencies at all levels ... Federal, state and local ... who obtain and use Federal dollars.
2. Requiring the contracting out of all audiovisual production except that production which is truly of a sensitive nature.
3. Restricting the National Audiovisual Center to distributing programs for internal use within Federal Government agencies or those programs for which no suitable for-profit distributor can be found after a vigorous competitive bidding search.
4. Encouraging programs such as the Office of Special Education, Department of Education, Market Linkage Project.
5. Requiring the Internal Revenue Service to more vigorously review the tax returns of non-profit organizations for unrelated business income, taxing such income equitably, and closing the loopholes favoring the non-profit organizations under the present tax structure.
6. Opening up the government grant awarding process making it possible for profit making companies to compete fairly with non-profits for these grants.

There is a legitimate role for government to play in audio-visual production and distribution for its own needs and there is a legitimate role to be played by non-profit organizations; but that role doesn't include unfair competition with the private, taxpaying small business.

Thank you, Mr. Chairman, for this opportunity to appear before your subcommittee and to make this statement. We will be glad to elaborate on any points we made, answer any questions the subcommittee wishes to ask, or provide additional documentation about this subject.

ATTACHMENTS TO THE
TESTIMONY SUBMITTED BY
EDWARD J. MEELL
TO THE
SUBCOMMITTEE ON ADVOCACY
AND
THE FUTURE OF SMALL BUSINESS
OF THE
U.S. SENATE COMMITTEE ON SMALL BUSINESS

JUNE 24, 1981

I remember Tom Magoun, at the University of Maryland, once telling me how he and his staff took all the guidance materials they had there in the counseling office and tried to classify them according to John Holland's six types (see *Making Vocational Choices: A Theory of Careers*, by Holland).

"In order to classify them," Magoun said, "we had to read them. It was very instructive. We threw half of them away when we found out how useless or outdated the pamphlets were."

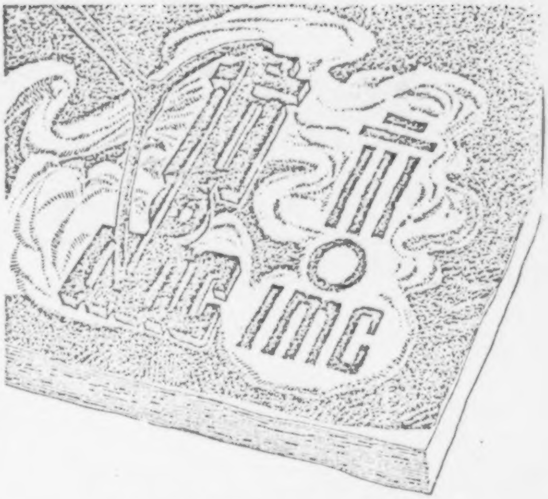
By the principle of "We Go First" I mean also that if we purchase some shiny-new package of career guidance materials, we be sure that we have "run" our own lives through that package, before we urge it upon the hapless (or helpless) counselee. I also mean that if we help students find field work, that we go out and try our hand at being a "beginning field worker" for a week or two, in one of the shops to which we will be sending our students.

And I mean that if we teach job-hunting, we be sure that we have gone out and tried the job-hunt using all the techniques we are teaching to job-hunters. To find out whether our resume really opens doors, or not, and to find out if we really can conduct an interview so skillfully (along the lines we are teaching the students) that we are actually awarded a job offer.

What all of this adds up to, as my first principle for improving career guidance, is best illustrated by the (one hopes) apocryphal story of one of the Asian wars of past times. Villagers, it is said, were sent out across a battlefield ahead of the troops, so that if any landmines had been placed there by the enemy, the hapless villagers would step on them first.

Career guidance would be vastly improved, I believe, if we who are career guidance persons would offer ourselves as the hapless villager, and offer to step on any landmines before the troops that we are guiding go across that same field. Materials, pamphlets, career guidance materials, instruments, methods, experiential learning, and job-hunting would thus get reduced only to those that were helpful to us as well as to the people we are guiding.

At one well-known university in this nation, the career guidance people once went through all their materials with the jaundiced eye I have here rec-



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Needed: More Info on AVA

We certainly have been impressed with the new cadre of AVA publications. They are well done and timely.

However, the new flow of information misses one point—what is AVA? For example, the VocEd *Insider* is filled with professional manuscripts, but a member of AVA still doesn't realize there are possibly many affiliates within a division—for example: NCLA, CEBOE, NATEBOE, NASBE, NASBOE, etc. . . . Could you pass a test on the above?

Perhaps the local chapters we are being encouraged to set up will be th key to AVA's future strength. But we can't expect increased membership without the basic understanding of th organization's components. AVA, it's your responsibility to spread the wor and get new faces involved.

Thomas J. Seymour
Director of Instruction
Ellsworth Community Colleg
Iowa Falls, Iowa

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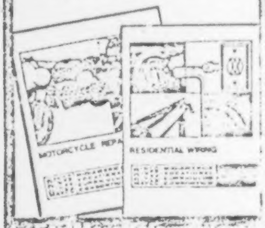

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Safety First

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Breathing Easy: Reducing Hazards of Farm Air Pollutants

One doesn't usually think of hazardous fumes down on the farm, but vocational agriculture students should be reminded that there are many farm jobs for which some form of respiratory protection is desirable to avoid nasal or lung discomfort or irritation—or is needed to avoid serious illness, accident or even death. *Farm Safety Review* Editor Jack Burke listed some of these jobs in a recent issue of that publication. Among them:

- Working in heavy dust or chaff such as tilling, harvesting, and cleaning up.
- Handling moldy hay.
- Applying fertilizer, lime, or other materials that involve heavy mineral dusts.
- Handling and applying many pesticide compounds.
- Working in silos, grain storage, and other closed areas lacking sufficient oxygen to support life (and which may also include toxic gases).
- Working in or around manure storage facilities where there are poison gases.
- Spraying paint
- Using solvents or other chemicals with noxious or toxic vapors.
- Working among pollen, spores, or other allergens if one is sensitive to them.

Exposures to farm air contaminants such as field, barn, and mineral (fertilizer, lime, and so forth) dusts, chaff, and pollen, can be annoying and may cause discomfort, irritation, and lead to long-term effects on health. To avoid this problem, respiratory protective devices should be worn, especially if the concentration of the particulate is substantial or if one is going to be exposed long enough for it to be bothersome. However, failure to wear a respirator during most of one's day-to-day farm work activities involving ordinary exposure to these contaminants usually isn't a life-or-death matter, says Burke, at least for the short run. But it could be for some other contaminants associated with the farm.

Some pesticides are poisons
get into the body via the lungs
cause severe illness and worse
ter exposure. Silo and manure
be extremely dangerous even w
exposure. Also, tightly closed s
storage bins may not contain e
oxygen to sustain life. Failure to
proper respiratory protection in
tions involving these hazards m
risking health, safety, and even

Generally, respiratory protect
equipment falls into two broad
devices that *clean* or purify am
such as filter respirators, chemic
tridge respirators, and gas mas
those that *supply* air either by p
it from a clean air location or b
cylinder that's carried on the ba

It's important for students to
when they need protection and
get the right kind. Remind them
ways read product labels for clu
what respiratory equipment mig
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products they sell. Another sou
information on respiratory prote
the county extension agent.

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thousands of safety signs and e
ment is available from Ready Ma
Company of Long Island City, N
catalog features signs in dozens
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Safety tips and news should be sub
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lington, Va. 22201.

features contained in the plan instead of just finishing one annual plan and immediately beginning to recycle some of the same components into another annual cycle.

It would be essential for states to have the capability to do sound intermediate and long-range planning if the three-year planning cycle is to be effective. The three-year state plan as an alternative will be addressed through recommendations in the legislation being developed.

Considerable thought is being given to constructing the proposed legislation for 1982 around population groups with sections on youth, adults and special needs. Concepts currently contained in the legislation would be incorporated into delivering programs and services to the populations under these sections.

Actually, one could logically make a case for only having a section for youth and a section for adults, with everything else being incorporated into these two sections. Some of the reasons being presented for this concept are: (1) It allows for vocational education to be directed to people instead of to institutions and methods. (2) It more nearly fits national priorities. (3) It would reduce categorical funding. (4) It would provide for more continuity in delivering vocational education among the components currently specified in the vocational education legislation.

Sections on planning, evaluation and information are clearly critical elements in the proposed reauthorization legislation. National priorities will greatly influence the content of the legislation dealing with these topics. Input is being sought from many sources to ensure that the directions taken can become operable and are, in fact, administered by those whom they affect.

About the author

Charles Hopkins is assistant state director for Supportive Services, Oklahoma State Department of Vocational-Technical Education, Stillwater.

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Circle No. 36 on Inquiry Card

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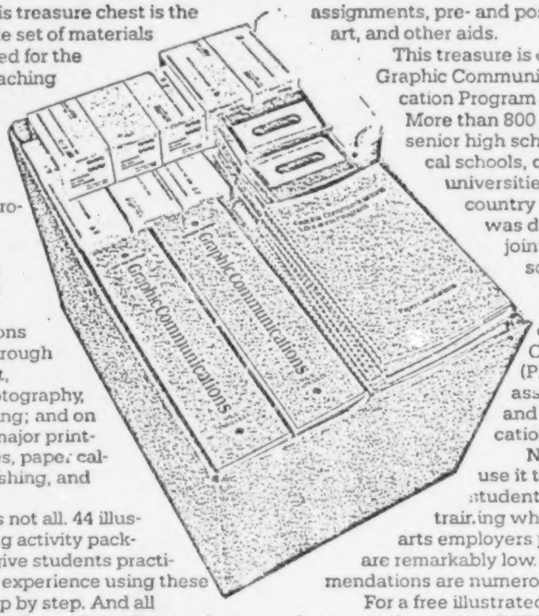

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Circle No. 28 on Inquiry Card

Sent to Ed McCall
Media Management Svc

edc women's educational equity act program

Dear Colleague:

As the Dissemination Center for the Women's Educational Equity Act Program (WEEAP) we have worked with you and many others throughout the country in an effort to provide materials and service that combat sex-role stereotyping and achieve educational equity.

We have tried to be responsive and resourceful in responding to your requests for these materials and services and we want to continue to be so. This past year has been one of tremendous growth for us with many excellent projects and products now available for national dissemination.

Inside are brief descriptions of the newest WEEAP projects and materials. We are certain you will be interested in these materials. Because EDC is funded by the WEEA Program within the Office of Education, (Department of Health, Education, and Welfare) these materials are sold at cost and are very reasonably priced.

We invite you to contact us for further information. Do not forget our toll-free number 800-225-3088 (for Massachusetts residents 617-969-7100). We shall look forward to hearing from you.

Sincerely,

Gail Odeneal

Gail Odeneal
Dissemination Coordinator

EDUCATION DEVELOPMENT CENTER, INC
55 CHAPEL STREET
NEWTON, MASSACHUSETTS 02160
TELEPHONE 617 969-7100

FEDERAL GOVERNMENT AUDIOVISUAL POLICY

1975

August 22, 1975:	GSA issues regulations regarding the use of Government personnel as performers in audiovusual productions. GSA issues regulations declaring motion picture processing activities to be commercial or industrial activities which are subject to OMB Circular A-76, and which should be contracted out.

1976

May 18, 1976:	White House Domestic Council requests information from AMP on impact of Federal Government Audiovisual production on private sector producers.
August 20, 1976:	Office of Federal Procurement Policy (OFPP) within OMB proposes regulations limiting motion picture production contracts to 60 motion picture companies. Requests industry comments.

1977

February 14, 1977:	Department of Defense (Air Force) proposes rules on procurement and utilization of audiovisual materials. Industry comments requested.
April, 1977:	President Carter singles out government filmmaking as a major target in his drive to trim waste and inefficiency in government, and hires Robert Lissit to coordinate a major review of government filmmaking activities.
May 9, 1977:	Office of Federal Procurement Policy revokes plan to permit only 60 companies to contract for motion picture production work and proposes new rules. Again, industry comments are requested.
June 11, 1977:	OFPP proposes rules for improving management of Federal audiovisual activities. Industry comments requested.
June 13, 1977:	OMB requests AMP input, within 30 days, on drafting proposed rule changes in OMB Circular A-76, which requires reliance on the private sector for needed goods and services.
October 19, 1977:	H.R. 9657 introduced by Congressman Edward Roybal, to establish uniform procedures for and regulate the procurement, production, and distribution of audiovisual materials by all Federal agencies. (referred to Gov't Ops)
November 21, 1977:	OMB issues proposed rules for A-76, government reliance on private enterprise. Industry comments requested.

1978

April 13, 1978:	OMB (OFPP) issues Circular A-114, final rules on Management of Federal Audiovisual Activities.
April 27, 1978:	White House releases results of Lissit Report on Federal audiovisual activities. The report which concluded that the government spends $500 million a year on audiovisual production -- most of it in-house -- prompted an Executive Order to eliminate waste and duplication. The report found that the Federal Government doesn't even know how many movies it now has, and that agencies are producing audiovisual materials that are designed merely to promote agency images rather than provide support for programs.

August 21, 1978: OMB again issues new proposed regulations governing reliance on private sector for goods and services (OMB Circular A-76). Industry comments requested again.

September 21, 1978: Congressman John Burton, Chairman of the Government Operations Subcommittee on Government Activities and Transportation holds hearings on Federal audiovisual programs. Industry presents testimony as do government agencies.

1979

March 8, 1979: OMB (OFPP) announces final rules on contracting for motion picture production.

March 29, 1979: OMB publishes OMB Circular A-76 Cost Comparison Handbook which provides detailed instructions for developing a comprehensive and valid comparison of the estimated cost to the government of acquiring a product or service by contract and of providing it with in-house, government resources

April 5, 1979: OMB issues final policy on reliance of private sector for goods and services (OMB circular A-76).

June 20, 1979: National Audiovisual Center issues report on Federal Audiovisual Activity Report for Fiscal Year 1978. It appears that more than half of the audiovisual production was conducted in-house.

June 26, 1979: Congressman Roybal and Waxman introduce H.R. 4624 to establish an Office of Federal Audiovisual Policy within OMB in order to "promote economy, efficiency, and effectiveness in the procurement, production, and distribution of audiovisual materials by the Federal Government" (referred to Gov't Ops).

July 20, 1979: OMB issues proposed policy on Videotape Contracting Systems, similar to the policy on motion picture. Industry had demanded that videotape be included when it became apparent that agencies were converting 16mm film production to video in an effort to circumvent OMB policy on contracting out for 16mm.

September 17, 1979: House and Senate Budget Committees report 2nd Concurrent Budget Resolution. Both versions retain an amendment from the 1st Concurrent Budget Resolution which reduced the budget by $250 million in funds used for government film production. (House 402-3; Senate 83-0)

September 26, 1979: President Carter signs Executive Order 12160, "Providing for the Enhancement and Coordination of Federal Consumer Programs", instructing agencies to "produce and distribute materials to inform consumers about the agencies' responsibilities and services, about their procedures for consumer participation and about aspects of the marketplace for which they have responsibility."

1980

January, 1980: SBA Office of Advicacy Task Force issues report on "Government Competition: A Threat to Small Business", cataloguing examples of direct and indirect government competition with the private sector, including the audiovisual industry. The Task Force recommended that the preference for private enterprise be restored to Federal policy, and that the IRS code and its regulations be amended to distinguish between for-profit and nonprofit and to narrow the scope of "related business activity".

1981

January 5, 1981:	Congressman Roybal introduced H.R. 598 to create a Federal office for audiovisual policy.
April 20, 1981:	President Reagan issues a moratorium on all production and procurement of new audiovisual products and publications; all existing materials were to be reviewed to eliminate superfluous items and all departments and agencies were to submit a comprehensive report on projected savings by July 15, 1981.
June, 1981:	Both the House and Senate consider legislation to provide for the consolidation of education programs, specifically including provisions to award grants to non-profit agencies and organizations for the development and dissemination of educational materials.

Senator HAYAKAWA. Thank you, Mr. Meell.

We will now hear from Dr. Earl Hess of Lancaster Laboratories of Lancaster, Pa.

STATEMENT OF DR. EARL H. HESS, PRESIDENT, LANCASTER LABORATORIES, INC., LANCASTER, PA.

Dr. HESS. Mr. Chairman, I would like to ask you to change tracks now, to go from audiovisuals across to independent laboratories.

I am the founder and president of Lancaster Laboratories, a 20-year-old organization, representative, I think, of the independent laboratory community that exists across this country. No one knows exactly how many of us there are. We estimate somewhere in the 2,000 to 3,000 number, most being small businesses and, in fact, most of them smaller than our organization which numbers about 60 people.

I note that my testimony to be entered into the written record is probably one of the longest. I want to assure you that I will take just a few minutes to highlight and guide you through some of the issues that I think are important. I do request that the written testimony be entered into the record.

Senator HAYAKAWA. It will be so ordered and your statement will appear following your oral remarks.

Dr. HESS. Before getting into the issues and offering some examples of Government competition that I would like to describe, I simply want to pause for a moment to discuss the relationship between small high-technology businesses and innovation.

Small businesses in general, have been credited as being much more innovative than big businesses. There have been a number of studies made. We note that independent laboratories and research and development small enterprises, are really are the hotbed of invention, and that a disproportionate number of new technologies, patents, and processes come out of these enterprises.

Therefore, when we talk about Government competition affecting these small businesses, we are talking about Government competition impacting directly on the innovation process in our country.

A sizable section in my testimony deals two issues which may seem not significant at first glance, but on closer examination they are unique and vital to independent laboratories.

Direct Government competition, when one is talking about professional services, becomes significantly more complex than when he is talking about goods or more routine and definable services. One gray area relates to whether a professional service is one that should be a Government function and should be performed in-house, or possibly whether the professional service can be classified as research in the public interest and therefore is appropriate to be done by a nonprofit organization.

Second, although direct competition is very important to us, indirect, which is a more complex and delicate issue, is of predominant importance to us.

I would like to recall a statement that Mr. Hostetler made just a bit ago. In the process of addressing this issue, it is so easy for us to be misunderstood that we are against nonprofits or that we categorically condemn all of their activities or something like that. I would especially urge you to study that section in my written testimony which deals with the complexity of this problem in more detail than I possibly can here.

I would like to cite two or three examples of Government competition specifically impacting on the independent laboratory community. Two of them will be from my own experience and another from the experience of one of my colleagues which I think you find of quite some interest.

I will not deal with some of the more complex services that our laboratory offers but something that all of us can understand, namely, the testing of water.

Just a few years ago our laboratory expanded for the first time into another locality and opened a small branch in south central Pennsylvania. We saw a need for offering a water testing service there in the the interest of public health. We acquired the various EPA certifications and whatnot to offer those services.

We were aware in advance that our own State department of environmental resources would be in competition with us, but we were shocked to find that one of the local boroughs had its own water testing capability and was offering those services to the public for a fee.

The real clincher came when we realized that in the State of Maryland our Federal certification was not accepted. There was a loophole in the EPA Drinking Water Act that allowed States to structure their own certification programs which Maryland elected to do. We were told that there was no way that we could get certified.

Here we are sitting on the Pennsylvania/Maryland border with a current Federal certification and one-half of our business is simply and categorically eliminated. I have made an estimate that there is $10,000 to $30,000 worth of business there that I simply cannot address because of this competition problem, which for a small three to five person operation would be a nice way to get started.

The Department of Agriculture, by reason of our being in the agriculture, food, and environmental fields, has been of quite some concern to us. I can show you laboratory services specific fee schedules that are published by the Department of Agriculture that describe all kinds of testing services similar to my own at either no fee or on a nominal basis.

A much more complex issue is the Department of Agriculture's Extension Service. I cannot take the time to develop this complex issue today, but I will hope you would have the chance to look at it in my prepared statement. The Department of Agriculture Extension Service, the Penn State University's agronomy and various other college agricultural entities get embroiled in such a way that the net result is that practically any testing service that I can offer on a legitimate for-profit basis can be obtained at a much lower price through one or another of these agencies.

I would like now to direct you to an example from the experience of one of my colleagues which I think is one of the real horror stories that came out of the task force hearing. It appears on page 18 of my testimony, namely, the DSET example of Mr. Zerlaut. I cannot go into the details here, but I would like to impress upon you that if there was ever the right person at the right time with the right service to offer, Gene Zerlaut was such a person.

He essentially wrote the book in the technical aspects of solar collector evaluation, a very important issue by reason of our country's energy situation. Yet today he sits on the brink of going out of business for one reason and one reason only. That is the Government competition situation which he has had to face.

I hope you will take the opportunity to read his story as it appeared in Inc. magazine describing this scenario.

In conclusion, I would like to make about three recommendations. I think one has already been mentioned. That is that the general public and everybody involved in this issue simply needs more education. A lot of Government competition with small business arises because of naivety, not because anyone is deliberately out to get us.

I think that these hearings represent a very positive step in that direction and I want to congratulate you and thank you for holding them.

I would like to suggest that another item is the passing of the Hayakawa resolution, which to me, at least with respect to direct competition, says what needs to be said. I would like to suggest the insertion of one word at a couple different places. There are cases where the words "private enterprise" are used. I would be happy to see "private taxpaying enterprises" substituted. As you review my written statement, especially on the indirect competition and certain A-76 provisions, you will understand why I make this suggestion.

Finally, I would like to recommend that the committee continue to explore ways of addressing this problem, especially moving on from your resolution now to the more complex issues involved in indirect competition.

Thank you, sir.

[The prepared statement of Dr. Hess follows:]

STATEMENT OF

DR. EARL H. HESS, PRESIDENT
LANCASTER LABORATORIES, INC.

before the

SUBCOMMITTEE ON ADVOCACY AND THE
FUTURE OF SMALL BUSINESS
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

on

GOVERNMENT COMPETITION WITH SMALL BUSINESS

June 24, 1981

My name is Earl H. Hess. I am President of Lancaster Laboratories, Inc., Lancaster, Pennsylvania, a small research, development and analytical services firm which I founded 20 years ago. I appreciate the opportunity afforded me to describe to you the impact of both direct and indirect government competition, not only on my own business, but on the community of small independent laboratories in general. I speak from this broader base by reason of my association with the American Council of Independent Laboratories (ACIL) in the capacity of Executive Committee member and Chairman of its Government Relations Committee. A still broader background on the subject before this Committee today was gained through my service on the 1980 SBA Task Force Report on "Government Competition: A Threat to Small Business," and my involvement with the U.S. Chamber of Commerce (member of Small Business Council) and the National Federation of Independent Businesses (member of Action Council).

Through my experience in these organizations, I have become aware of the pervasiveness of government competition with small business of every kind. In my testimony this morning, however, I intend to restrict my focus to my own community, independent laboratories, those small businesses that provide services in research and development, analysis and testing.

My testimony will follow this outline:

1. Statement of the Issue;
2. Examples of Government Competition with Independent Laboratories;
3. Some Hopeful Indicators of Progress;
4. Recommendations for Improving the Situation;
5. Conclusion.

I would like to point out that the bulk of my testimony will focus on indirect government competition. While direct Federal competition is serious and growing, I believe that there is even less awareness by the public and its elected officials of the complex and serious policy problems flowing from business activities of nonprofits.

The General Issue of Government Competition

The U.S. Government should not compete with its citizens. Few would argue this point, in theory. But, in fact, competition from the Government is a common occurrence, one that has serious negative implications for private-sector firms, especially small ones like independent laboratories.

The Government competes directly with private businesses in a number of areas. A recent letter from the Comptroller General of the United States, Elmer Staats, to the Director of the Office of Management and Budget, David Stockman, stated:

> In addition to performing governmental functions, Federal agencies perform commercial and industrial activities that are available through contractual arrangements from the private sector. Services such as janitorial, guard, and keypunching are examples of services that can normally be provided

> by the private sector without endangering the governmental process. . . . OMB information shows that Federal agencies are curently operating over 11,000 commercial and industrial activities at an estimated cost approaching $20 billion annually. This amount represents nearly one-third of total fiscal year 1981 Executive branch employee compensation. An OMB official estimated that as many as 400,000 Federal employees are required to operate these activities."

In what is probably a more damaging, although less obvious, manner, the Government competes with the private sector indirectly. It does this every time it grants some form of financial advantage to a nonprofit or not-for-profit organization that competes in the marketplace with commercial businesses. The justification for the many financial advantages (tax breaks, equipment grants, special postage rates, import duty waivers, etc.) enjoyed by institutions is their public service function. When these publicly funded resources are used in support of commercial, proprietary work and not the tax-exempt mission of the nonprofit, the Government is indirectly competing with its citizens.

Approximately 11 percent of the Federal research and development budget for fiscal year 1977 ($23.5 billion) was allocated to research and development performed at universities. Of this amount, 89 percent was "applied" and "development" activity, directly competitive with similar services available from the private-sector professional services community.

In addition to universities, "captive" nonprofit research institutes - Federally Funded Research and Development

Centers and Federal Contract Research Centers - and "non-captive" nonprofits, like Franklin Institute, Battelle Memorial Institute and Stanford Research Institute, devote a substantial portion of their resources to providing proprietary services to commercial and industrial clients.

The situation is made even more inequitable in cases where the nonprofit research institutes have, in fact, been formed by a Federal agency assuring them the opportunity to work for that agency. Examples include: RAND, Aerospace Corp., Mitre, etc. Equally incongruous are college and university laboratories which not only enjoy tax-exemption on work which may or may not be regarded as "research," but are frequently supported by Federal grants to buy equipment and facilities.

Examples of tax-free competition with private engineering testing firms include: A New England University seeking work in the soils testing and foundation design field; a West Coast research lab offering to perform environmental impact studies for the Navy; a research institute in Ohio performing a $142,000 contract for preparation of air quality control implementation plans; a government-spawned research institute conducting an air transportation study for the State of Washington; a Southern University performing a $100,000 contract to develop a mathematical model of a river basin; a well-known research institute seeking areawide planning studies contracts under the EPA 208 program. In these, and numerous other examples, eminently-qualified, private firms are available and equipped to perform identical services and to pay a fair tax on income derived from these services.

It is clear that the expansion of nonprofit organizations into the commercial sphere is contrary to public policy. Public policy does not favor nonprofits performing testing and analytical research services that are ordinarily undertaken by commercial laboratories. The history of nonprofits and their role in society establishes that the sole reason that such entities enjoy special privileges and benefits, such as tax exemption, is to encourage and promote their public interest goals. Within the last twenty-five years, however, this centuries-old tradition of service has been increasingly abused by nonprofit corporations using their special privileges and benefits to pursue commercial goals in unfair competition with tax-paying organizations.

Prior to the 1940's there were few problems from "charities in business" or nonprofit organizations since the corporate tax rates were low, most philanthropy was carried on by public or quasi-public institutions, and there was little business activity by nonprofits in general. With the advent of World War II, science and technology became central to the security and future of free nations. The Federal government necessarily directly involved itself in an accelerated development of the technical capabilities of the nation, including utilizing nonprofits to achieve national goals in science and technology by filling gaps which private enterprises were not able to meet. Following the war, the Federal government's need for technical innovation not only to achieve military goals, but space and other non-defense objectives, combined with rising tax rates to generate a phenomenal growth in high technology research activities and an explosive growth of nonprofits to undertake such research. At the same time, private professional service firms became an integral part of the economy and developed broad capabilities in research and development, among other areas of professional services work. But as these private sector capabilities developed, nonprofits did not phase down their activities or convert to for-profit status, for the most part, they vigorously expanded in direct competition with private sector firms.

Nonprofit corporations of all sorts were created at such a rate that they now average one-fourth to one-third of all corporations nationally. By 1965, for example, the Research Center Directory listed 3,200 nonprofit research centers in the U.S. and Canada. By November, 1969, the number had increased to 5,329 (P. Dickson, Think Tanks 19 (1971)). Nonprofit testing laboratories now average a large percentage of all testing laboratories competing in various fields and geographic areas. (American Society for Testing and Materials, Directory of Testing Laboratories (Phila. 1977).) The nonprofit sector's share of the national income grew over 50% from 1960 to 1973. Nonprofit enterprises are still growing more rapidly than profit oriented organizations, according to H. Oleck, Non-profit Corporations, Organizations, and Associations 1 (3d ed. 1974).

The problems stemming from nonprofits competing in the marketplace have become so widespread that Congress sought in the 1950's to use the tools at its disposal, the Federal income tax exemption for charitable, educational and scientific research organizations, to deal with them on a national scale. The "unrelated business income" tax provisions of the Revenue Act of 1950 and the Tax Reform Act of 1969 were fundamentally intended to reduce "the unfair competition which exists when a tax-exempt organization engages in competition with tax-paying business," (96 Cong. Rec. 13273 (1950) remarks of Senator George). The legislative history of these Acts reflects concern about the economic leverage tax exemption provides, as well as the serious problem of nonprofit organizations diverting their interest, attention, and funds from their proper functions of carrying on charitable, educational, or other activities. In 1950, Congress provided for the taxation of "unrelated business income" of nonprofit corporations because of the growing "unfair competition" with for-profit companies, particularly citing the use of future tax-free earnings to expand operations. (H.R. Rept. No. 2319, 81st Cong., 2d Sess. 36 (1950); S. Rept. No. 2375, 81st Cong., 2d Sess. 28-29 (1950).) At that time research and development for Federal and State governments was excluded from taxation because such activities were not ordinarily undertaken for profit. In 1969, the unrelated business income provision was expanded for the same reason, continued unfair competition by nonprofit corporations. (H.R. Rept. No. 91-413, 91st Cong., 1st Sess. 44 (1969); S. Rept. No. 91-552, 91;st Cong., 1st Sess. 67-71 (1969).) The House Committee on Ways and Means and the Senate Finance Committee also concluded that a serious problem stemmed from managers of nonprofit organizations becoming "so interested in making a success of the business, or in meeting competition that most of their attention and interest is devoted to this with the result that what is supposed to be their function, that of carrying on charitable, educational, etc. activities is neglected." (S. Rept. No. 91-552, supra at 39; H.R. Rept. No. 91-413, supra at 27.) These legislative efforts to deal with the problem have not been adequate. Ten years has passed and the problem has become even more severe. One example of the loopholes under the current law is the fact that a non-profit organization's income from any research and development activities for a governmental unit is not subject to Federal income tax. Income generated by universities performing research of any nature, whether or not performed for private clients in competition with private laboratories, is exempt from the Federal income tax.

The economic effects of competition between tax-exempt nonprofit corporations and for-profit corporations has been described as follows:

> The specific business advantage possessed by an exempt business is a higher rate of return on capital. A tax-paying corporation requires a taxable income of approximately twelve percent of its investment in order to realize a net profit of six percent (assuming a fifty percent tax rate). If an exempt corporation cut its prices to a point producing a six percent return, its taxed competitor would realize only a three percent net return at the same price assuming that production and marketing costs are about equal. Such a profit would be so much lower than that realizable from other investments that a prudent manager would have little incentive to retain investments in a field where tax-exempt competition existed.
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> * * * *
>
> While the competitive advantage of ability to cut prices varies greatly from industry to industry, the fast accumulation of capital made possible by tax-free profits is an advantage in any field. Where the market is expanding, the exempt enterprise will have a greater surplus to invest in production and distribution facilities, and in anticipation of higher net profits, can compete more effectively for supplies, capital assets, and outside financing. Even in an industry with inelastic demand the untaxed business will be able to invest in improvements at a faster rate than its competitors. (The Macaroni Monopoly: The Developing Concept of Unrelated Business Income of Exempt Organizations, 81 Harv.L.Rev. 1280, 1281-82 (1968).)

It is clear that intrusion of nonprofit organizations into the commercial sphere, except in carefully defined ways which serve the public interest, is against sound public policy. The requirement that a nonprofit serve the general interest requires enunciation of specific standards and guidelines governing when and under what circumstances a nonprofit can provide commercial services in competition with qualified private firms.

The urgency of recognizing limits required under the applicable law is emphasized by one commentator's statement as follows:

> The state of law and practice in the field of nonprofit organizations, generally speaking, can be described only as a mess. Considering the importance of these organization forms and privileges in the United States, their vast contributions to the American (and other) progress and welfare, and the general lack of awareness of the size of the problem of their abuse and governance, the prospects for decent nonprofit laws, operations and (above all) effective supervision, are ominously bad.
>
> * * * *
>
> Present laws, practices, and lack of skillful and ample supervision, combined with normal human instincts towards self enrichment - all combine to make a worrisome problem out of what should be a joyous and very proud part of our society: the nonprofit organizations. (Oleck, Non-Profit Types, Uses, and Abuses: 1970, 19 Cleveland State L. Rev. 207, 233 (1970) (Emphasis added).)

Why is it important that the problem of government competition be addressed and that reasonable, practical corrective action be taken? Certainly, there is a degree of self-interest underlying the position of the small independent laboratories. Our members want to stay in business and make a legitimate profit in a marketplace where all competitors compete on equal terms. But there is much more than self-interest involved here. Independent laboratories exemplify the kind of technical capabilities in the private sector that must be nurtured if the United States is to achieve its economic and social goals in the 1980's and beyond.

Innovation and productivity are paramount concerns of the United States at this time in our nation's history. We must take all means possible to reverse the decline in innovation and productivity that has occurred over the past decade. One important way to do that is to create a more favorable climate for small, high technology firms, like independent research and analytical laboratories. Studies too numerous to mention have established beyond doubt the fact that it is in this type of private-sector business that innovation and productivity flourish best. The National Science Foundation's Science Indicators 1976 cited one such study which reviewed major innovations between 1953 and 1973. It found the following:

- Small firms produced about 24 times as many major innovations as large firms and nearly four times as many as medium-sized firms per R&D dollar expended.
- Small firms also had a ratio of innovations to R&D employment four times greater than large firms.
- The total number of major innovations by small firms was greater than by large or medium-sized firms.
- The total cost per scientist and engineer was almost twice greater in firms of over 1,000 employees as it is in firms of less than 1,000 employees.

The conclusion, therefore, draws itself. One practical step that the U.S. Government can take to promote innovation and productivity is to do something about the problem of government competition.

Government Competition With Independent Laboratories

Let me begin my description of the nature and effects of government competition with laboratories with the situation most familiar to me - my own laboratory. Lancaster Laboratories is a small independent laboratory providing research, development, analytical and consulting services in the areas of agricultural production, processing and consumption of food, environmental issues and industrial processes. Our clients are individuals, small, medium and large private businesses, governmental agencies, trade associations, consumer organizations and colleges and universities. I started Lancaster Laboratories in 1961 with a staff of three persons; the staff today is 60, 52 of whom are full-time employees. Twenty-five of these individuals are professionals holding graduate degress in chemistry or biology. In twenty years of business, Lancaster Laboratories has never laid off a single employee for lack of work.

Because Lancaster Laboratories provides services in the areas of soils, food and water, we have had a wealth of experience with three major Federal agencies: the Department of Agriculture, the Food and Drug Administration, and the Environmental Protection Agency. Each, in its way, has made life more difficult for this small businessman.

My special peeve with USDA is its Agricultural Extension Service. Over the years, this program, as implemented at most state universities, has come to mean help for any segment of society (consumers, municipalities, industries, and others). Programs for soil testing, waste analysis, lawn care, home economy, etc. have proliferated. In short, an attitude has been promoted to the public that if you need anything done or any information, just call your agricultural extension agency. This has been accomplished, of course, by subsidizing the programs with tax dollars to keep the services either free of charge or low enough for anyone to afford. Aside from philosophical considerations of the long-term effects on our social and economic systems, this public-sector provision of services has driven viable, tax-paying small businesses out of these legitimate areas of business and has prevented new competition from entering the market. Further, the legitimatization of agricultural extension services in the public mind has very subtly permitted departments within the state universities that were established strictly for educational purposes to become entangled in the commercial marketplace, often with the misguided blessing of government agencies. Numerous examples of sole-source use of university facilities by federal and state governments can be cited.

Our laboratory has developed over the past ten years, with after-tax investment dollars, the facilities and the personnel in trace element analysis that find us doing work for diverse clients all across the country. Yet, Pennsylvania State University's agricultural extension service has a subsidized monopoly on the elemental analyses performed on soils, forages, etc. When elements other than the major soil nutrients are called for, the samples are sent to the University's agronomy department for routine analysis on equipment presumably purchased by grant monies for research and educational purposes. Because of some research performed by the University agronomy department on farm land application of sewage sludge, the department has also promoted repetitive analytical services to the public, particularly municipalities. They have established a separate, well-equipped laboratory in another building on campus devoted solely to environmental analysis of sludges. When toxic organic analyses such as pesticides or PCB's are called for, the University agronomy department conveniently sends them over to the pesticide lab of the agricultural extension service. We have learned that our state government's department of environmental resources sanctions this set-up by recommending the University agronomy department to municipalities and actually sending a large portion of their own work to the University agronomy laboratory.

We estimate the dollar value of business annually from the sludge work alone to be in the $20-50,000 range. All of this work could readily be performed by private laboratories such as our own.

Penn State is not the only university we have encountered in competition with our trace analysis work. A few years ago a client in Pennsylvania asked us for a quotation for repetitive trace analysis of human hair. Soon thereafter we learned that the work was going to Case Western University in Ohio for less than half the cost of our bid. Recently, we observed the same company is advertising drinking water analyses, including trace elements, and actually naming Case Western in its advertisement as the one doing the work. Unlike our laboratory, there is no requirement that Case Western prove its creditibility to the U.S. Environmental Protection Agency by site visitations by the federal agency, or by satisfactorily analyzing unknown levels of trace elements in performance drinking water samples each year.

Several years ago, a request for proposals was issued by the Food and Drug Administration related to the development of methods of asbestos analysis in foods, an area in which we felt highly qualified. We joined forces with Structure Probe, Inc. of West Chester, Pennsylvania, in the submission of a joint proposal which merged the expertise and equipment of the two small laboratories. We lost the competitive bid to the Franklin Institute. When investigating the matter with FDA procurement personnel, we learned that it would have been illegal for them to apply a non-profit/for-profit differential that would take into account the funds that would be recycled to the Federal government by the for-profit bidder. In other words, the cost to the government in lost taxes by contracting with a non-profit organization could not be included in the evaluation of the Franklin Institute's proposal. Interestingly, after two years with little if any progress by the Franklin Institute, another contractor was sought. This time, Structure Probe-Lancaster was awarded the contract and was successful in performing the assigned task.

Three years ago, our company opened its first branch operation in Franklin County (South Central) Pennsylvania. Although the need for independent laboratory services in the area was well-established, our efforts to promote our water-testing capabilities faced some unexpected competition. We were, of course, aware in advance of the direct competition by the Pennsylvania Department of Environmental Resources through legislative mandate, but we soon came to realize another competitor, the Borough of Chambersburg that operates its own water laboratory, but also offers water testing for a fee to surrounding smaller municipalities and private citizens. Further, we learned that we were completely barred from all work in Maryland requiring certification by reason of the State's non-acceptance of EPA certifications and the lack of any program by which an independent laboratory can be recognized within the state. These examples of government competition in the area of water testing illustrate well how a combination of a government's interest in the public safety and naivete and subtlety in the bureaucracy combine to exclude small business from its legitimate markets. I would estimate that our branch laboratory is losing $10-30,000 of business annually which would represent our fair market share of the area business now conducted in-house by government.

Our laboratory does only a limited amount of business with the Federal government. One of our major reasons is the unfair competitive advantage enjoyed by not-for-profit contractors. I could give you hosts of examples where contracts are awarded to non-profits that represent pure and simple testing, have no research dimension whatsoever, and on which a non-profit should not even be allowed to bid. Even when the non-profit is a legitimate competitor, the small for-profit independent laboratory is at a competitive disadvantage because of its tax burden and many other financial inequities.

It should be stressed that many other facets of being a private for-profit laboratory, as opposed to a public or non-profit one, cannot be covered in this brief account. Just a few of these which do not affect the nonprofit laboratory are laboratory accreditation and certification requirements, profesional liability insurance, non-preferred mailing permits, and inability to retain equipment funded as part of federal research grants.

My experience at Lancaster Laboratories are limited, but the shapes and forms of government competition, even within the independent laboratory community, are virtually limitless. Time does not permit a recitation of the myriad instances of unfair competition reported by other laboratory representatives, but I want to give several prominent spokesmen opportunity to add to the record their own perspective on this insidious phenomenon. The following are first-person testimonies from three other laboratory presidents.

1. Gene A. Zerlaut, President of DSET Laboratories, Phoenix, Arizona, told his story in the Forum section of the October 1980 issue of Inc. magazine. It follows:

> I have nothing against competition in a free market -- in fact, I welcome it. But when competition from the public sector is injected into a market, companies in the private sector can be quickly wiped out.
>
> Government-supported universities, in particular, enjoy a privileged position. With grants for equipment, they don't have to amortize their facilities through earnings. They don't pay state and federal taxes. Because much of their work is done by graduate students, their labor costs are often quite low. And universities never have to earn a profit. But we do, and competition from universities, subsidized at taxpayers' expense, has seriously hurt our business.
>
> We're a testing lab that before 1975 specialized solely in "weathering," the outdoor testing of materials. With the Arab oil embargo and the subsequent explosion in solar energy develop-

ment, however, we decided to enter the solar collector testing market. Relying on our expertise in outdoor testing, we assembled a state-of-the-art collector testing facility at our Arizona headquarters in February 1975.

Because there is a relatively short period when innovators rush to the labs with new products in an emerging technology, we knew that our success in solar collector testing would depend on how well and how quickly we could establish ourselves in the field. We predicted that a shakeout would occur after a few years and the number of new designs in need of testing would drop off precipitously. Our reputation could not be built gradually in this field, so we committed ourselves to it completely.

By the summer of 1977, DSET was considered a leader in the solar collector testing field, and we believed that we might someday amortize our nearly $200,000 in test facilities. At about this time, however, the Department of Housing and Urban Development invited a large group of "independent test laboratories" to participate in a testing program for solar hot water heaters. Using information supplied by the National Bureau of Standards, which had conducted its own series of tests, and several others sources, HUD issued a list of labs it believed capable of meeting test standards.

Three of the laboratories on the HUD list had tested only one or two collectors, and one university lab had the temerity to ask DSET to identify all the equipment needed to perform the tests. Subsequently, the HUD list was widely circulated in the industry and provided a de facto certification to all participating labs without distinguishing the good from the merely adequate. With the stroke of a pen, we were reduced to the least common denominator.

Earlier, in the fall of 1976, the Florida legislature had directed the Florida Solar Energy Center, a facility operated by the state university system, to set up a collector testing and certification program. Where before the FSEC engaged primarily in research, it suddenly was brought into the field of commercial testing. In addition, the legislature granted the FSEC sole authority to certify collectors in the state. Manu facturers could still take their solar collectors to independent testing labs, but each test had to be certified by the FSEC. That certification cost an additional $300. Two years later, the legislature passed a measure requiring all contractors wishing to sell and install collectors in Florida to use only FSEC-certified equipment.

The state's action sent all but two or three of our 33 Florida customers over to the FSEC and wiped out one of our largest client bases overnight. In addition, some of our customers from outside Florida switched to the FSEC to take advantage of the lower rates the tax-supported center charged and to gain Florida certification, which is accepted by several other agencies and state boards.

In the meantime, we've tried to hold onto the business we have, but actions by the government, most notably the Department of Energy, have cut into our business. In 1978, for instance, the department announced a program of free and subsidized tests for solar collectors and sought bids from all "qualified" labs. New orders dropped off immediately, and some customers even cancelled tests, preferring to wait for the free ride.

Just to secure a reasonable share of the market, we were forced to bid at little or no profit.

In an attempt to diversify, we have moved into photovoltaic testing, but we may be stymied there, too: Florida State University recently asked the DOE for $18.5 million to set up the world's largest solar energy testing facility. If the DOE agrees, the FSU center would go a long way toward ending any role in solar equipment testing private sector labs might still have.

No one has said private labs can't do the job, or that subsidized labs are better suited to the task, yet universities are crowding the market. They weren't created to compete with private firms -- their job is to supply technology and trained people to the private sector. But if universities are allowed to drive private firms out of business, their graduates are going to have a lot of trouble finding work outside of the schools.

2. Dr. Charles Garber, President of Structure Probe, Inc., West Chester, Pennsylvania, described his problems to me as follows:

> Structure Probe, Inc. is an independent for-profit laboratory and analytical professional services firm, specializing in the use of our own (and very costly) electron microscopy and related facilities for solving problems for industrial clients, but also for government and academia. The work we perform covers a wide range of scientific disciplines, from metallurgy, ceramics, and electronics to polymers and the life sciences. Our gross sales, including those from a related microscopy supply division are over $1 million annually.
>
> Structure Probe, Inc. was founded in 1970 with virtually no capital and from an initial two employees, has grown to an organization employing more than 30 persons, approximately half professionals, spread among four locations, three in the U.S. and one in Canada. In ten years of business, which covered some tough economic times for small businesses, we have never laid off a single person for lack of work.
>
> What came as a complete shock to me, after going in business, was to learn that our major competition was not another firm such as our own (as such had sprung up in other major metropolitan areas), but a not-for-profit, the Franklin Institute, located only a few miles away from my facility. This competitor (1) paid no federal or state income tax, (2) imported equipment duty free, (3) sent out advertising on a non-profit mailing permit, (4) received substantial subsidies from the federal, state and local governments, and (5) was free from the burden of a number of other taxes. such as the state sales and use tax.
>
> As a consequence, Franklin's Scanning Electron Microscope (SEM) was substantially lower (30-40 percent) than our prices or those charged for comparable services in other parts of the U.S. As a result of these unfair advantages, Franklin Institute monopolized SEM services in my geographic region, the Delaware Valley.

My experience in seeking governmental assistance in eliminating these unfair advantages has been an exercise in futility. Let me summarize:

a. Internal Revenue Service:

In the period 1971-1972, I began to contact the IRS in Philadelphia, Tax-Exempt Branch, to find out how it was that Franklin, a not-for-profit, could be running business in direct competition with private sector commercial firms. Despite repeated calls and several meetings, I have received no indication that IRS is prepared to take remedial action.

b. Bureau of Customs

Inquiry was made as to why the Bureau of Customs permits duty-free entry of scientific equipment, even though it is clearly destined for substantial use for the benefit of commercial firms. I was referred to the Department of Commerce (which had referred me to Customs!). The answer was that Commerce rules on the technical merits, and Customs rules on the information contained in the duty-free entry application. However, Customs has no enforcement procedure in the event the duty-free items turn out to be used for commercial purposes. As a not-for-profit, Franklin can apply for duty-free entry whereas private sector firms cannot.

c. U.S. Postal Service

Inquiry was made as to why Franklin can send out advertising material under its non-profit mailing permit. The Postal Service said that the not-for-profit status granted by the IRS is sufficient; if the activity meets with approval at IR, then it is OK with the Postal Service.

d. Federal District Court (Structure Probe, Inc. v. Franklin Institute, Eastern Pennsylvania (#72-2071)

In October 1972, a two-count suit was filed by our firm against Franklin alleging antitrust violations and violations of its corporate charter. After numerous delays on the part of the Defendant, an astonishingly slow Federal court system, a five-week Federal trial and almost $100,000 of expenses, a decision was finally handed down against us in May, 1978. We appealed that decision to the U.S. Court of Appeals for the Third Circuit, but that body upheld the decision of the District Court. Although we could not convince either court that Franklin was violating the law, we remain convinced that there are significant differences between not-for-profits and for-profit commercial firms. The fact that we failed in our efforts to apply existing Federal antitrust and state corporation laws to the abuses we have identified, emphasizes the need for reform in present laws and policies.

3. The words that follow are those of Herman Hochschwender, President of Smithers Scientific Services, Akron, Ohio.

From personal experience, I can testify to the feelings of frustration and to the financial stress, as well, that occur from unfair competition from a tax-favored organization.

In 1969, the state of Ohio constructed an automotive facility, known as the Transportation Reserach Center, near East Liberty, Ohio. Ultimately costing the taxpayer $34 million, the testing center, by 1977, had accumulated losses totaling $5,755,000. Not once, during the years between 1969 and 1977, did the state-owned facility operate in the black. Moreover, TRC has never listed depreciation expenses in its report to the public of annual operating expenses. Depreciation on $34 million, over a 30-year period, could be expected to add approximately $1 million more to the facility's annual general losses. It's obvious that Ohio taxpayers, including my own firm with which it is competing, have been heavily subsidizing the operations of the state-owned testing facility.

As one of the privately-owned testing facilities that formerly accounted for approximately 10% of TRC's annual volume, my company, Smithers Scientific Services, was justifiably upset when TRC began making sales calls on our clients, offering them testing services at rates considerably lower than the rate that Smithers was required to pay TRC for use of its facility! At approximately the same time, TRC was offering use of its facilities to Ohio State University at a

> rate 50% lower than the rate being charged to Smithers, an obvious violation of the FTC regulations on discriminatory pricing.
>
> In 1979, the Governor of Ohio aggravated the situation by transferring operation of the entire TRC facility to Ohio State University. This has resulted in another taxpayer institution operating and managing a facility in direct competition with private, tax-paying firms. It can be surmised that, by placing the money-losing operating under the benign umbrella of a large university budget, less public outcry will result from its operating losses. It also makes it more difficult for firms in the private sector to obtain redress for improper pricing practices.

There is a footnote to Mr. Hochschwender's story. A news release was issued by the U.S. Department of Transportation on June 17, 1981. It announced that

> . . . a joint government-industry program to test devices, products and concepts designed to improve the fuel economy of trucks and buses.
>
> The free testing program will be conducted by the department's National Highway Traffic Safety Administration at its track facilities in East Liberty, Ohio. Test results will provide truck and bus companies with a library of reports which the agency hopes will encourage innovative fuel saving ideas.
>
> NHTSA Administrator Raymond A. Peck said, "These new energy concepts tests will offer an opportunity for manufacturers, carriers and the public to see the results of objective fuel-economy tests, and could encourage the wider use of fuel-saving technologies by the industry."

None can dispute the laudible goal of this program. We do question its being described as a "free testing program," however. It is subsidized by U.S. taxpayers, like Mr. Hochschwender. We also question whether the goal might be better met by recourse to capable tax-paying research facilities like Smithers Scientific Services. Important national needs can be addressed without adding to the incidence of government competition.

Some Hopeful Indicators of Progress

In spite of the proliferation of instances of government competition, there are also positive developments. These hearings, increased awareness of the problem, cases of enlightened cooperation between the government and commercial laboratories, and sometimes the nonprofits themselves. The record of these hearings would be incomplete if we did not cite some prime examples of these hopeful indicators.

The most obvious example is your consideration of the work of the special Task Group on Government Competition that was convened by the Chief Counsel for Advocacy of the Small Business Administration. The product of that body is a 200-page volume entitled, "Government Competition: Threat to Small Business." The book is required reading for any person seriously interested in this issue.

The National Science Foundation has also shown leadership in recognizing the importance of small, for-profit, high technology firms and in developing a sensitivity to the adverse impact on such firms from direct and indirect government competition. Two recent NSF activities illustrate these points.

The Small Business Innovation Research program, begun in 1978, constitutes an important departure for NSF, an agency whose traditional constituency has been universities. This new program increases the opportunities for small business science and technology firms to engage in government-funded applied research projects. NSF solicits high risk, potentially high payoff research proposals from small businesses and makes initial grants based on the feasibility of the idea, the qualifications of the principal investigators and the potential for significant public benefit from the project. Funded projects that show real promise after six months and that have attracted a commitment for follow-on venture capital from a third party, are awarded more substantial additional funds from NSF. The Department of Defense recently announced the initiation of a Defense Small Business Advanced Technology Program that is modeled after this excellent NSF program.

NSF also deserves praise for taking a leadership role in the search for constructive resolution of the problem of indirect government competition. Over the past months an internal NSF Task Group has been discussing the question of "Relations Between Commercial Organizations and NSF-Supported Research Facilities." The Federal Register of June 10, 1981 (p. 3739) carried notice of the fact that the Task Group has prepared two documents that are now available to the public and about which NSF invites comment.

Two passages from the latter document indicate how far NSF has come in addressing the matter of government competition:

> To these ends the Committee recommends the following principles to guide NSF policies and practices

in the establishment and operation of NSF-supported facilities:

I. When the NSF holds a competition to select a research-facility manager, all types of institutions, including commercial firms, should be eligible to compete.

II. When the NSF and scientific communities it supports are considering new facilities or deciding whether existing faciltieis are still needed, they should seek out commercial capabilities and should determine what benefits using, upgrading, or expanding those capabilities would offer.

III. The terms of agreements with managers of NSF-supported facilities should safeguard the purposes of NSF support and should prevent unfair competition with commercial services or facilities.

IV. The NSF should encourage involvement of scientists from industry in the construction, operation, and management of university-run facilities it supports.

These principles and the discussion of them that follows are meant to provide general guidance, not to impose or propose rigid rules.

* * * *

II. When the NSF and scientific communities it supports are considering new facilities or deciding whether existing facilities are still needed, they should seek out commercial capabilities and should determine what benefits using, upgrading, or expanding those capabilities would offer.

This second principle goes beyond the first to urge active effort by the NSF and the research communities it assists to avail themselves of opportunities in the commercial sector. The point is not to interpose substantive or paperwork obstacles in order to head off possible criticism from buisness; it is to encourage creative use of commercial capability for the benefit of science.

The NSF obviously should not establish or maintain a facility at all if equivalent service to scientific research and education can be obtained from a commercial firm or firms at equal or lower cost. That would be a foolish use of money. But the NSF rarely encounters the obvious situation in which the capability required is already commercially available. If adequate state-of-the-art service were conveniently available at reasonable cost from a commercial source, NSF-supported scientists would not be eager to divert NSF funds to another such facility.

The NSF might, however, be able to help commercial firms upgrade, expand, or even start up facilities or services. That might obviate construction of facilities or long-term institutional support for facilities by the NSF. Scientific users might well be better served at lower cost through such a commercial alternative.

NSF staff and advisors who come predominantly from the academic community might not be fully aware of commercial potential that could be developed to meet facilities needs. Established habits of thought and operation may have a tendency to eliminate such commercial options prematurely. Similarly, commercial firms might be unaware of potential NSF interest in supporting multi-user services or facilities. Hard creative work to identify capability in the commercial sector, to interest commercial firms, and to devise arrangements with them might open new opportunities for the NSF and for science.

A first step might be more strenous efforts to identify potential commercial sources and to make them aware of NSF interest in establishing or supporting multi-user facilities or services. Such efforts might range from publishing in the Commerce Business Daily to conducting a survey of potential commercial sources.

The NSF may be more effective in tapping the potential of such sources if it has and displays willingness to use forms of support or incentive other than the conventional grant or contract the NSF usually uses. It might be able to help a potential commercial provider secure financing by purchasing a block of time or service on the facility in advance or by guaranteeing minimum use of the facility by NSF-supported users. The NSF might even consider lending directly to the potential commercial provider. Or it might be able to help arrange other loans or loan guarantees through the Small Business Administration or other Federal programs. The ability

> of the NSF to effectively use such techniques has not yet been tested, but it has authority to use them, and they might well be tried. Willingness to try them might be signalled when potential commercial providers are notified or otherwise contacted about NSF interest.
>
> Some industrial laboratories have equipment that is not available in most university laboratories. The NSF might help arrange access to such equipment for university researchers. The NSF might even furnish specialized auxiliary equipment, as it did at a Federal laboratory in establishing a small-angle neutron scattering facility at Oak Ridge.
>
> In some cases commercial firms may be able to provide users of an NSF-supported facility ancillary services, such as sample preparation or routine characterization of samples, more efficiently and inexpensively than the facility itself could.
>
> In short, there are many possibilities for creative arrangements with commercial firms that might, if actively pursued, produce more benefit to science at less cost.

The Department of Energy showed a similar sensitivity to potential government competition with small business in 1979, when it was drafting guidelines for its proposed University Coal Research Laboratory (UCL) Program. (The program has since been shelved, but that does not negate the validity of the DOE officials' enlightened attitude.) (When ACIL coal testing members saw notice of the program, they contacted DOE to learn more about it and to convey their apprehension about the potential for government competition with the private sector.) Several sessions of constructive dialogue ensued. As a result, when the final rule was published, important changes were made, and the following explanatory notes accompanied the rule:

> Comments on the role and functions of coal characterization in the UCL Program were particularly helpful. The proposed rule adopted the language of the Act in referring to the establishment of "test laboratories for coal characterization." The words "test laboratory" infer a routine coal testing func tion, which if permitted might result in direct competition with established independent, commmercial laboratories. On the other hand, research to advance the knowledge and understanding of the fundamental characteristics of coals is considered essential to many areas of coal research. Based on comments received, a new section 320.2(c) has been inserted defining "Coal Characterization Research." Also, references to coal characterization in sections 320.4, 320.5, 320.8 and 320.11 have been modified to delete the words "test laboratory" and to stress the research nature of coal characterization. These changes clarify the role of coal characterization in the UCL Program to significantly reduce the potential for unfair competition with independent testing laboratories. An applicant for participation in the UCL program is required to set forth a program for coal characterization research which complements and assists other coal research proposed in the application. This coal characterization program must clearly show that it will not duplicate or supplant the services normally provided by commercial testing laboratories. (Sec. 320.5, Functions of University Coal Research Laboratories, has been revised to incorporate this determination.) A proposed coal characterization research program may utilized new or existing facilities or be conducted wholly by or jointly with other private or public organizations.

The Small Business Development Center legislation (S. 2698) that was signed into law last year, after some heated debates in the Senate Small Business Committee and on the Senate floor, has become the occasion of another constructive dialogue on the issue of government competition. ACIL stated its reservations about the legislation because we believed the SBDC model embodied in it is weighted too much toward universities and not enough toward small business. Nevertheless, a few months after the bill was enacted, officials of ACIL and other private sector organizations and leaders of the SBDCs decided to try to work together to ensure that the hopes of the SBDC proponents might be fulfilled without the fears of its opponents being realized. We hope these discussions will lead to guidelines that will reduce substantially the potential for government competition that is inherent in the SBDC program.

My final "success" story is one especially important to me, because the subject is a creature of my home state of Pennsylvania and because I have been privileged served on its board of directors for the past four years. The program is the Pennsylvania Technical Assistance Program (PENNTAP) administered by Penn State University. Please allow me to quote at some length from a recent PENNTAP document, the "Role of the Technical Specialist." This excellent piece describes PENNTAP and its operating principles. In doing so, I think it offers an example that might be followed elsewhere to reduce government competition with small business.

> PENNTAP was conceived in 1965 as a vehicle for transferring technological information to the points in the marketplace where it could have practical use and create positive benefits. It was designed as a statewide network that could assist Pennsylvania organizations to receive and apply known and proven scientific and technical information. It was, in the eyes of state government leaders and Pennsylvania State University administrators, a project that could help business

and industry overcome problems which hindered their ability to progress and stay competitive.

PENNTAP is a continuing education service of The Pennsylvania State University. It is funded in part by the Pennsylvania Legislature through the Department of Commerce. At times, under special contracts, it receives funds from and performs special services for other state government departments. This university-government-private sector partnership works in a way that offers Pennsylvania enterprises a competitive edge for growth and development through science and technology.

The delivery of its technology transfer services is accomplished by utilizing the statewide network of 24 Penn State campuses and continuing education offices. These provide a local link between the organization in need of help and the technical specialists who can provide that help. Thus, PENNTAP's staff is accessible to every section of the state. . . .

The Line Between Public and Private Services: A fundamental principle upon which our democratic free enterprise system is built is that government should not compete with the private sector but rather should rely upon it for the provision of the goods and services needed by the government and by the general public. Federal policy in this regard is spelled out in OMB Circular A-76, revised in 1979. Yet in real life the increasing tendency is for governmental expansion of services and for increasing reliance on government for free assistance by the average citizen. This has eroded the stated policies and small for-profit businesses are first to feel the effects. Studies show competition for private business comes from universities, other not-for-profit institutions as well as from government agencies.

There is a fine, not easily drawn line between services provided by PENNTAP and those available from private firms such as consulting engineers and independent laboratories. As a service supported in part by tax dollars, and in part by Penn State Continuing Education self-generated dollars, it is a partial extension of government. Within the mandate not to compete with private services PENNTAP does not create "new" knowledge or data but relies on the use of existing and available information. It has private consultants and engineers serving as members of its Advisory Council as a means to stay in line with its missions and its operating practices.

The legitimacy of PENNTAP's activities as a dissemination organization is furthered by the strength of its performance as a uniquely qualified unit that has ready access to a source of non-proprietary technology generated at universities and government sources with public funds.

Many times, the PENNTAP user does not appreciate the distinction between PENNTAP's type of service and the type of service which would be in competition with the private sector. Technical specialists must understand the limitations of their role in sharing relevant state of the art information with Pennsylvanians. They need to be sensitive to the necessity to resist pressures and requests to expand their services into areas covered equally well by private professional service organizations.

Recommendations For Improvement

My involvement in the series of "success" stories just noted leads me to make a prefatory comment before recommending specific corrective actions. My observation is that exposure and education are essential first steps on the road to adequate remedy. In every case cited, the principal architects of constructive approaches were initially unaware of the dimensions of the problem of government competition with small professional services firms like testing laboratories. Once aware, they showed themselves willing to alter course and take meaningful action.

These hearings are commendable, therefore, because they further the process of exposure of a problem insufficiently recognized and of education both of the general public and of those in positions of power.

STATEMENT OF GEORGE S. OSTROWSKI
PRESIDENT, BUSINESS MANAGEMENT RESEARCH ASSOCIATES, INC.
BEFORE THE
SENATE SUBCOMMITTEE ON ADVOCACY
AND THE FUTURE OF SMALL BUSINESS
June 24, 1981

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear this morning to discuss Government competition with small businesses. I previously testified before the Advocacy Task Group on Government competition with small business. I have also worked with the General Accounting Office, the Office of Management and Budget, and the Department of Defense in evaluating economy and effectiveness of alternative sources for needed goods and services.

I am president of Business Management Research Associates, Inc. We are a small business engaged in research and analysis of business and material management functions for both Government and industry. The Department of Defense is one of our major customers. We also help industry, particularly small businesses, in the techniques of doing business with the Government.

My views today will be directed to the purchase of commercial products, their distribution to the point of use, and the repair parts needed to keep commercial equipment operational. Commercial products are off-the-shelf in seeking profit for himself, creates a beneficial social climate. Business provides jobs and a better standard of living. Business provides a climate of self-fulfillment, satisfactions and accomplishments that in other economic systems are impossible. This has proven true in my own 20 years as a small businessman. That is why I react strongly to government competition and other threats to the free enterprise system. It is why I applaud the leadership that the Chairman of this Subcommittee has shown in calling these hearings and in introducing his private sector resolution.

Senator HAYAKAWA. Thank you, Dr. Hess.

Before hearing from you, Mr. Ostrowski, I want to point out that there is a vote on the Senate floor. Therefore, I think it would be wise if we were to take a 10-minute recess. After I vote, I shall be back and we shall proceed.

[Recess.]

Senator HAYAKAWA. We shall continue these hearings with the testimony of Mr. George Ostrowski, president of Business Management Research Associates of Arlington, Va. We will be happy to hear your testimony, Mr. Ostrowski.

STATEMENT OF GEORGE S. OSTROWSKI, PRESIDENT, BUSINESS MANAGEMENT RESEARCH ASSOCIATES, INC., ARLINGTON, VA.

Mr. OSTROWSKI. Thank you for the opportunity to discuss the issue of Government competition with small business. I previously testified before the Advocacy Task Group on Government Competition With Small Business. I also worked with the General Accounting Office, Office of Management and Budget, and the Department of Defense in evaluating economy and effectiveness of alternative sources for needed goods and services.

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My views today will be directed to the purchase of commercial products, their distribution to the point of use, and the repair parts needed to keep commercial equipment operational.

Commercial products are off-the-shelf items sold in the industrial/commercial marketplace at catalog or market prices. They include repairable equipment as well as consumable items.

I was chairman of the Commercial Products Study Group of the Congressional Commission on Government Procurement. This task force reviewed the policies and practices of every Government agency in buying and using commercial products.

We also solicited comments from industry, especially small businesses. Their biggest complaint was that the process of Government purchasing of commercial products is based on use of Government depots and Government distribution systems that are in direct competition with commercial distribution channels.

The Commission analyzed the Government depot cost of purchasing and warehousing the commercial products and compared these costs with central nonstock programs and local contracts where commercial distribution channels were used.

It was found that in fiscal year 1971, the value of the commercial products purchased by the General Services Administration and Defense Supply Agency, which is now the Defense Logistics Agency, exclusive of fuels, clothing, food, and medical supplies, was $1.3 billion. The purchase and warehouse costs for this Government depot activity was $608.9 million, which is equivalent to 47 percent of the product value.

During the last 10 years, no additional study of this magnitude has been conducted, but experience indicates that purchasing and warehousing costs have greatly increased.

In addition to these depot costs, a Government installation has to review stock catalogs, requisition, and receive the property. This cost averages about 50 percent of product value. Therefore, the total delivered cost for Government distributed products is approximately twice the purchase price.

These products are sometimes bought through commercial distribution channels using local contracts, small purchase procedures, or central nonstock contracts. The purchasing costs using these direct delivery procedures averages about 25 percent of the product price.

Even when an estimated 20 percent additional cost of paying retail prices is added to the commercial distribution prices, there is a potential saving of about 50 percent of the product value by use of commercial distribution over Government distribution.

Applying this 50 percent factor to the $1.3 billion of commercial products bought by Government depots in fiscal year 1971 reveals a potential annual saving of $650 million by use of commercial distribution procedures. An example of actual savings was the Defense Logistics Agency conversion from Government stock to direct delivery of X-ray film in 1977 for an actual saving of over $2 million.

The cost of making nonstock purchases of low dollar value at depot level is also twice as high as at the point of use. The GAO recently reported that the cost of making small purchases by the General Services Administration is over $85 and the average dollar value of the transactions is only $34.

The Office of Federal Procurement Policy, Office of Management and Budget, has issued policy directives to Federal agencies on acquisition and distribution of commercial products. This policy is to use off-the-shelf products and commercial distribution channels whenever they satisfy Government needs.

This policy was supplemented in 1980 by a pamphlet to provide guidance on how to analyze and use the commercial marketplace. In addition, the Department of Defense has developed a manual on how to implement OMB policy, but it is not yet published.

The OFPP is now developing a new Federal procurement system and Federal procurement directives that will provide for use of commercial products and distribution channels as public policy. However, I am convinced that until there is public visibility of the cost to purchase and deliver these products to the point of use, we will not make the best use of off-the-shelf products or of commercial distribution and support services. This cost visibility would be required by your resolution, making it basic policy to rely on the competitive enterprise system to provide needed goods and services.

The OFPP will also be proposing legislative reform that will provide for consideration of total cost savings when buying commercial off-the-shelf products that are already made and are sold competitively in the marketplace. This legislation is also needed to provide a basis of making procurement decisions on the basis of lowest ultimate total cost rather than lowest item price at the time of purchase.

Thank you, Mr. Chairman. That concludes my statement. I would be happy to respond to any questions you may have.

[The prepared statement of Mr. Ostrowski follows:]

Chief among the latter, of course, are the members of the U.S. Congress. You and your colleagues have the power to enact statutes that can curb abuses and bring equity to an unfair system. The following are some of the measures we believe the U.S. Congress should take:

1. Enact the Hayakawa Resolution, namely, that "It is the policy of the Government of the United States to rely on competitive, private industry to supply the products and services it needs." Respectfully, we suggest that this resolution be amended by insertion of the word "tax-paying" between "private" and "industry." Reasons for this suggestion are found on all the preceding pages of this testimony.

2. Extend the preference for private, for-profit enterprises to cover all Federal monies committed to state and local governments.

3. Amend the Internal Revenue Code and its accompanying regulations to more clearly distinguish between for-profits and non-profits and assure proper tax treatment of organizations engaged in commercial activities.

Conclusion

In conclusion, I thank you, Senator Hayakawa, and the members of your subcommittee for affording me this opportunity to expound on a subject about which I care deeply. I have long felt that private enterprise is the life-blood of our democratic society and that the individual, items sold in the industrial/commercial marketplace at catalog or market prices. They include repairable equipment as well as consumable items.

I was chairman of the Commercial Products Study Group of the Congressional Commission on Government Procurement. This task force reviewed the policies and practices of every Government agency in buying and using commercial products. We also solicited comments from industry, especially small businesses. Their biggest complaint was that the process of Government purchasing of commercial products is based on use of Government depots and distribution systems that are in direct competition with commercial distribution channels. The Commission analyzed the Government depot cost of purchasing and warehousing commercial products and compared these costs to central non-stock programs and local contracts where commercial distribution channels were used.[1/]

It was found that in Fiscal Year 1971 the value of the commercial products purchased by the General Services Administration and Defense Supply Agency,[2/] exclusive of fuels, clothing, food and medical supplies, was 1.3 billion dollars. The purchase and warehouse costs for this Government depot activity was 608.9 million dollars which is equivalent to 47% of product value. During the last ten years no additional study

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[1/] Part D, Volumn 3, Report of the Commission on Government Procurement, December 1972.

[2/] Now the Defense Logistics Agency.

of this magnitude has been conducted, but experience indicates that purchasing and warehousing costs have greatly increased.

In addition to these depot costs a Government installation has to review stock catalogs, requisition and receive the property. This cost averages about 50% of product value, so the total delivered cost for Government distributed products is approximately twice the purchase price.

These products are sometimes bought through commercial distribution channels using local contracts, small purchase procedures or central non-stock contracts. The purchasing costs using these direct delivery procedures averages about 25% of the product price. Even when an estimated 20% additional cost of paying retail prices is added to the commercial distribution prices there is a potential saving of about 50% of the product value by use of commercial distribution over Government Distribution. Applying this 50% factor to the 1.3 billion dollars of commercial products bought by Government depots in FY71 reveals a potential annual saving of 650 million dollars by use of commercial distribution procedures. An example of actual savings was the Defense Logistics Agency conversion from Government stock to direct delivery of X-ray film in 1977 for an actual saving of over 2 million dollars.

The cost of making non-stock purchases of low dollar value at depot level is also twice as high as at the point of use. The GAO recently reported that the cost of making small purchases by the General Services Administration is over $85 and the average dollar value of the transactions is only $34.[3]

The Office of Federal Procurement Policy, Office of Management and Budget, has issued policy directives to Federal agencies on acquisition and distribution of commercial products. This policy is to use off-the-shelf products and commercial distribution channels whenever they satisfy Government needs. This policy was supplemented in 1980 by a pamphlet to provide guidance on how to analyze and use the commercial marketplace.[4] In addition, the Department of Defense has developed a manual on how to implement the OMB policy, but it is not yet published.

The OFPP is now developing a new Federal Procurement System and Federal Procurement Directives that will provide for use of commercial products and distribution channels as public policy. But I am convinced that until there is public visibility of the cost to purchase and deliver these products to the point of use, we will not make the best use of off-the-shelf products or of commercial distribution and support services. This cost visibility would be required by your resolution

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3/ Effectiveness of GSA's Practice of Centrally Purchasing Low Dollar Value Items under the Non Stores Program (MASD-81-12), March 31, 1981, General Accounting Office.

4/ A Guide for the Acquisition and Distribution of Commercial Products, OFPP Pamphlet No. 2, Executive Office of the President, Office of Management and Budget, April 1980.

making it basic policy to rely on the competitive enterprise system to provide needed goods and services.

The OFPP will also be proposing legislative reform that will provide for consideration of total cost savings when buying commercial off-the-shelf products that are already made and are sold competitively in the marketplace. This legislation is needed to provide a basis of making procurement decisions on the basis of the lowe. ultimate total cost rather than lowest item price at time of purchase.

This concludes my statement. I'll be pleased to respond to any questions you may have.

Senator HAYAKAWA. Thank you, Mr. Ostrowski.

Again let me say when I ask a question, all three of you are invited to chime in with whatever you may have on your mind in response to the question.

Mr. Meell, in your testimony you state that 70 to 80 percent of Government-produced audiovisual materials could be produced by the private sector. Is the private audiovisual industry capable of absorbing all this work each year?

Mr. MEELL. I think it would be more than capable of absorbing that work because of the number of young people coming into the communications field to make films, video programs, and slide programs. Yes, I think it would provide a lot of employment and they could absorb that volume of work.

Senator HAYAKAWA. Would you elaborate on the way in which the Federal grant process restricts competition in the audiovisual industry?

Mr. MEELL. Federal grants are limited to State agencies and nonprofit organizations. A private for-profit company cannot compete for a Federal grant from many of these agencies, whether it is the Office of Education or the Department of Health and Human Services. They make a grant to an organization. The organizations, which is either a State agency, a local agency, or a nonprofit agency, are the only ones that can apply for those grants. I, as a private business person, cannot apply for those grants. I am excluded totally.

I might add that I do not think the moratorium that the Reagan administration has on audiovisual production includes nonprofits. I think it only includes the for-profit sector, which is even a little more ironic.

Senator HAYAKAWA. Dr. Hess.

Dr. HESS. Could I comment on your first question to Mr. Meell?

Senator HAYAKAWA. Yes.

Dr. HESS. Oftentimes the stated reason for not contracting out to small private businesses is because the capability is supposedly not in place. Therefore, the Government has to find it in-house or in a university or nonprofit institute.

These people must simply recognize that small businessmen cannot have a highly sophisticated capability sitting there waiting for somebody to utilize it. We are governed by the rules of the marketplace.

Senator **HAYAKAWA**. Of course.

Dr. **HESS**. I would only say that small business is probably more able to respond quickly to a need than any other entity.

Senator **HAYAKAWA**. Thank you.

I have a further question. Could you elaborate on the Department of Education's market linkage project and why you favor the program? Could other Federal agencies adopt similar programs?

Mr. **MEELL**. To answer your second question first, yes, they could adopt them. I would urge them to adopt similar programs.

The market linkage program was established to provide a link between the developers of programs, in most cases universities or research centers that were funded by grants and sometimes by contracts by the Office of Education, and to take those programs that were developed and to provide a link between them and the commercial distributor out in the marketplace so that the commerical distributor then picks up the program and disseminates it to the marketplace.

That is a giant step in the right direction. I would encourage all the Government agencies to be required to do that.

Senator Hayakawa. Thank you.

Any other comments on this?

[No response.]

Senator **HAYAKAWA**. Mr. Ostrowski, why is the cost of using commerical distribution channels so much less than that of Government depots?

Mr. **OSTROWSKI**. Mr. Chairman, commercial distribution is a highly competitive activity that serves the entire Nation. Government purchasing and warehousing is, in effect, a duplication of this activity. The cost by the Government of cataloging, of developing specifications, of purchasing with the complex procedures that are involved, the receiving, and the warehousing is a very costly and people-intensive activity. There is a lot of paperwork involved. Obviously it is a lot easier and a lot more economical for industry to perform that same task.

Senator **HAYAKAWA**. That is, industry can do the warehousing and stockkeeping for you.

Mr. **OSTROWSKI**. The buying as well much more cheaply. There are alternative ways of purchasing through the commerical distribution system to provide the products to the point of use. That is the objective.

When some of these new techniques are developed to provide all of the supplies for a particular function at the point of use, that can be streamlined. There is no warehousing involved and paperwork is reduced significantly.

As an example of that kind of activity, at Fort Belvoir they have a motor pool that——

Senator **HAYAKAWA**. Where?

Mr. **OSTROWSKI**. At Fort Belvoir in Virginia.

They have all kinds of vehicles of several makes, models, and years including buses, sedans, and trucks. They have a Government maintenance operation, but all of the parts for supporting that fleet are contracted with one small business. That business is right there at the operation. Whenever a mechanic needs any part, he goes directly to the supplier. He does not have to put together a requisition and submit it to some Government depot to get the part. The small business either hands it to him directly from their little stock or can come into town to obtain the parts through other commercial sources and provide the stock to the Government.

This is an example of how contracting using commercial distribution and a small business operation can be done much more effectively and cheaply than can be supported through a Government operation.

Senator HAYAKAWA. Does this hold true for much of the maintenance work done for machinery, trucks, and so on on military bases?

Mr. OSTROWSKI. I think it is only true within the Air Force and Marine Corps. This is the first operation for the Army. Generally, the Government does not use this kind of a support operation because it is contrary to the general practice of buying things in quantity by determining requirements, buying them, stocking them, and distributing to the point of use.

Senator HAYAKAWA. Dr. Hess, I gather you see a relationship between the innovation process and Government competition. Would you talk a little bit more about this innovation process and the impact of Government upon it?

Dr. HESS. Yes. I cannot recite chapter and verse detail on all the studies that have been done. There have been hearings on the subject and there have been a number of studies that have clearly shown the innovative productivity of small businesses, especially high technology small businesses. There were comparisons, for example, of the productivity per scientist, the cost of maintaining a research scientist in a small business versus a large business or Government laboratory. The yield per dollar invested is something four to six times greater than in big business or in Government.

I think there is a very obvious reason for this. As I look back on the early years of my own business, there is more of a driving force toward productivity and frugality when the success of an innovator dictates whether or not he stays in business the next week or two.

I am simply saying here that insofar as Government competition has impeded me, has forced me to take detours rather than heading down the road I had planned, it has been a restraint on my business in addition to all the other headaches that I as a small businessman need to deal with. It seems at times that I am spending more time worrying about staying in business than I am innovating.

Senator HAYAKAWA. Dr. Hess, in the Lancaster Laboratories, you do very little business with the Federal Government directly. Is that correct?

Dr. HESS. A small percentage, yes.

Senator HAYAKAWA. What would encourage you as a small business to do more business with the Federal Government? Government agencies themselves would have to have some initiatives in this direction in order to seek you out.

Dr. **Hess**. One of the examples I give in my prepared statement concerns a contract on which we bid and lost because of price to a nonprofit organization. We were discouraged of course after going through all the proposal preparation, et cetera, when there is not any equity. We confronted the FDA procurement people in that regard saying, "How can you equate our bid with a nonprofit bid when a certain percentage of our dollars are going to be recycled by way of taxes?" They said it would be illegal if they did not compare them on a straight dollar-to-dollar basis.

Incidentally, 2 years later, after the Government spent a whole lot of money and got nothing out of that nonprofit, they solicited proposals again and we did the job.

Then there are payment problems: How you get paid by the Federal Government; the complexities of auditing; the very fact, for example, that one may not list interest on the money he has tied up on Government overdue receivables as an allowable overhead factor. When I am paying 19 or 20 percent interest, presently, and if that is not overhead, I do not know what is.

Mr. **Meell**. If I might comment on that, in the audiovisual industry, several agencies do contract out for audiovisual production. They normally make an announcement of the RFP like on June 1 and they request you to come back with 6,000 pages of documentation by June 21. It seems to me that in many of those cases the small business is discouraged from even applying for the contracts where they are trying to contract out by the paperwork.

The small business people do not have the staff to sit down and develop all this material, much of it boilerplate, which they do not understand or cannot understand in terminology. Then they just give up and say they do not want to work with the Government. I think that is also dangerous.

Senator **Hayakawa**. Thank you, Mr. Meell.

I would like to inform all three of you that I am a cosponsor of S. 881, which is the small business innovation bill.

We will submit the rest of the questions to you for answers. I therefore thank all three of you for appearing and for your statements.

[Subsequent information was received and follows:]

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 30, 1981

Mr. Edward J. Meell
President
Media Management Services, Inc.
865 South Cresent Boulevard
Yardley, Pennyslvania

Dear Mr. Meell:

I personally would like to thank you for testifying before the Subcommittee on Advocacy and the Future of Small Business on Wednesday, June 24, 1981. I believe that our initial investigation into the extent of government competition with small business was both enlightening and thought-provoking. I am looking forward to further, in-depth hearings on this important issue.

As I mentioned during the hearing, I did not have the opportunity to pose all of the questions I had hoped to ask. Accordingly, I have enclosed additional questions and would very much appreciate your written response for the official hearing record. Any additional comments you have for the record are welcome also.

If you have any questions about these materials, please do not hesitate to call Kimberly Elliott with the Small Business Committee at (202) 224-3840 or Grace Hussie on my personal staff at (202) 224-3841.

Again, thank you for your participation in what I believe was a very productive hearing.

Sincerely,

S. I. HAYAKAWA
Chairman
Subcommittee on Advocacy and
the Future of Small Business

MEDIA MANAGEMENT SERVICES, INC.
10 NORTH MAIN STREET SUITE 301
YARDLEY, PENNSYLVANIA 19067
215-493-1211

EDWARD J MEELL
PRESIDENT

July 9, 1981

The Honorable Senator S. I. Hayakawa
Chairman, Subcommittee on Advocacy and
the Future of Small Business
United States Senate
Washington, DC 20510

Dear Senator Hayakawa:

In response to the questions raised in your letter of June 30, I would like to submit the following answers:

Question 1: The marketplace for the services Media Management Services provides its clients in the audiovisual industry is nationwide, not local. My company and my clients have both suffered indirect or direct government competition in at least three ways:

A. Grants made by various government agencies to produce materials are made to state and local agencies, universities, schools and non-profit organizations. My company and its clients are not eligible to compete for these grants, yet they must compete in the marketplace with products that are developed as a result of these grants. Competition is eliminated in the grant process. Instead, we'd like to see the grant process eliminated and true competitive bidding substituted for it. The number of grants made annually for audiovisual production is in the millions of dollars, dollars the private sector can't compete for. The result? Lost business for my company and my clients and lost employment and lost taxes.

B. The short deadlines and endless forms required to answer government RFPs and compete for government contracts further reduces or eliminates the competition for these contracts from the private sector. Perhaps this is what the government agencies hope will happen when they announce a RFP, require pages upon pages of proposal forms, and then give you three weeks to respond! Over the last three years, I personally have passed up the chance to bid for $500,000 worth of contracts because of this problem. I simply don't have the time, the staff or the know-how to figure out this process. Ironically, many universities, school district and non-profit organizations have full-time staff people paid for with U.S. Government funds who do nothing but fill out the paperwork for government grants and contracts! I guess I might too if someone else were paying my staff.

C. The distribution of government audiovisual programs by the National Audiovisual Center (NAC) has precluded distribution of those programs by my company or by my clients. I estimate that my own small company has lost $75,000 to $100,000 in commissions and profit over the last three years that I would have earned if I could have been involved in acting as the agent for my clients in identifying potential government distribution of product or in distributing it directly myself. This is lost revenue that I would have paid taxes on. The National Audiovisual Center not only pays no taxes, it costs the government money to manage the distribution of product "from your U.S. Government" (See attached). The National Audiovisual Center should be required to contract this distribution service out to the private sector and distribute only internally to other agencies of the Federal government or only those titles for which no private distributor can be found.

Question 2: Yes, there would be increased benefits to the government if the audiovisual product and services it requires were provided by private, tax-paying audiovisual companies. These benefits would be both tangible and intangible and include the following:

A. Better product, better produced with less duplication of titles. The U.S. armed forces alone have three or four films on how to brush teeth!

B. More employment in the private sector to produce the product or perform the services. Government employees now engaged in this activity could be re-deployed to other jobs within government that are more critical (especially in the Department of Defense) or could find jobs in the private sector where their salaries and retirement would be paid by them and the employer and not the U.S. Government.

C. More government revenue through taxes paid on payrolls and profits from business done for the government and not by the government.

D. Reduction of risk that we end up with a "national" curriculum that is funded, produced, distributed and bought with Federal funds. Some of the Federal employees I've talked to might not think to avoid this potential eventuality is a "benefit" to government since they'd like to enlarge their empire ... and staff and pay ... by producing more and more audiovisual programs. However, we should avoid it and work to get the Federal government out of the production and distribution of educational audiovisual learning materials.

INTENTIONAL
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E. Reduce Federal spending by $500 million and perhaps two to three times that much. If the government has genuine needs, let them be known and the private sector will produce to satisfy them ... either under contract more cheaply or on their own if the market is big enough. The government would save the overhead, the marketing and probably some of the manufacturing and production costs.

F. Would provide more product for export to other countries thereby helping our balance of trade and returning some money to the government in the form of taxes. For example, if I distributed the Health and Human Services film I mentioned in my original, written testimony, I'd sell it in Australia, Europe, Canada and Latin America. I'd pay taxes on my profit and would even pay a royalty to the government on my sales for the privilege of selling that film. As it is, HHS is paying to have it distributed in this country only. Result? No foreign trade sales. No taxes paid. No royalty. I think the HHS official who approved this deal is almost guilty of malfeasence in office.

In short, the government should benefit in many ways by contracting out. All agencies should be required to do this as your resolution calls for unless the program is truly classified information or there is only a "thin" market for it.

I hope these answers are beneficial to your investigation. In addition to the answers, I've also attached two other things:

1. Some additional brochures showing examples of government competition from NAC, the U.S. Air Force and PATH. What is PATH doing competing with Berlitz? I would appreciate having them entered into the record.

2. Copies of my letters to Senator Heinz, Senator Spector and Congressman Coyne urging them to support your or Congressman Dreier's resolutions. I hope they will give that support.

Thank you again for the foresight and courage to start to address this critical issue. Best wishes for much success in completing your work and getting your resolution adopted. I would be more than happy and willing to continue to work on this problem if you'll let me know how I might help. Meanwhile best of luck with your field hearings. Warmest regards.

Cordially yours,

Edward J. Meell

Edward J. Meell

EJM:jl

Enclosures

AWARD WINNERS

THE NATIONAL AUDIOVISUAL CENTER PRESENTS A COLLECTION OF CONTEMPORARY CLASSICS IN EDUCATIONAL MEDIA

WINNERS OF THE ACADEMY AWARD, EFLA BLUE RIBBON,
U.S. INTERNATIONAL FILM FESTIVAL GOLD CAMERA AWARD,
AND CINE GOLDEN EAGLE

PRODUCED BY THE
UNITED STATES GOVERNMENT

The Award Winners

Deemed superior by experienced media users who understand your needs and share your high standards, these films and videocassettes are valued for their creativity, timeliness, and most important, content. They're investments that you can feel confident about—and each one can be obtained for your media program from the central source for Federally produced audiovisuals, the National AudioVisual Center.

The Criteria

These productions have been honored at festivals, acclaimed by critics, and enjoyed by millions nationwide. Upon viewing, you'll discover that they stand apart from other educational media, because they:

- probe beneath the surface of their subjects, illustrating rather than merely describing
- arouse interest, trigger ideas, and promote discussion
- cut across topics from science to the humanities, from history to human development
- enable viewers to experience events that have shaped our country and our culture
- cost much less than you would expect to pay for award-winning titles

Best of all, they'll help make your educational, community, or business enrichment program a winner!

The Subjects

This comprehensive National AudioVisual Center collection covers such topics as

Social Studies—re-experience history through documentaries and authenticated re-enactments:

Prelude To War—witness the events leading up to WWII (p. 20)

Roy Wilkins—The Right to Dignity—motion pictures of Martin Luther King, Jr., John F. Kennedy, and Wilkins himself, along with protests of the 1960's, highlight this vivid biography (p. 16)

Independence—watch as our forebears secure America's freedom (p. 18)

Science—explore the dynamics of nature through microphotography that exposes minute life forms in **Living Waters of the Big Cypress** (p. 4), as well as the telescopic probes of **Who's Out There?** (p. 3)

Guidance—examine contemporary concerns in [illegible]:

Working On Working—what happens when the handicapped are mainstreamed into vocational programs? (p. 12)

Two To Get Ready—see how both parents can prepare for the experience of childbirth (p. 11)

The Newest Winners

Shelley & Pete (. . . & Carol)—teenagers are catapulted into adulthood with the arrival of a baby (p. 11)

The Global Weather Experiment—an international team of scientists investigates the far-reaching effects of weather on our environment (p. 6)

Rethinking Tomorrow—realigning lifestyles today to ensure energy supplies for the future (p. 7)

The Cast and Producers

You'll recognize Dr. Carl Sagan, Rob Reiner, Penny Marshall, Orson Welles . . . and enjoy biographies about great Americans such as George Meany and Aaron Copland. Plus, you'll find classics directed by Frank Capra, John Ford, and Pare Lorentz—names respected in film communities everywhere. All of these programs have been carefully scripted and produced by Federal agencies including NASA, the International Communication Agency, National Park Service, and Department of Education.

The Praise

- About **Universe** (p. 3): "The color, photography, and, particularly, the special effects in the film are dazzling . . . an outstanding and enjoyable tour of our universe"—American Association for the Advancement of Sciences' *Science Books & Films* (September 1977).
- About **Reflections: Margaret Mead** (p. 15): "An irreplaceable document, especially to anthropology students and scholars, this fascinating film will also be welcome viewing for public library audiences interested in the analysis of human societies"—*Booklist* (June 1980).
- About **And We Were Sad, Remember?** (p. 11): ". . . this film stands out for its skillful handling of the reasons and the methods for talking with young children about death"—*Media and Methods* (December 1980).
- About **The River** (p. 19): "It did more to secure the popular recognition of the documentary film in America than any other picture"—Paul Rotha, *Documentary Film.*
- About **The True Glory** (p. 19): ". . . 80 minutes of priceless film . . . this motion picture stands as one of the enduring monuments to men at war"—Richard Dyer MacCann, *The People's Films.*
- About **Life?** (p. 3): "Great use of microphotography . . . easy-on-the-eye film which will make students *think* and wonder!"—*METROmessage* (June 1980).

Parents can help children understand death, as shown in *And We Were Sad, Remember?*

The Categories

Science and Technology
Space Exploration . . . Earth Sciences/ Nature Studies . . . Environmental Issues . . . Energy Concerns . . . Research and Progress 3
Health and Safety 10
Guidance
Human Development . . . Special Education . . . Careers 11
World Cultures 13
Arts and Humanities 14
Profiles 15
Social Studies
History . . . Americana . . . Documentary Classics 17
Ordering Information 21

Science and Technology

Space Exploration

Universe

27 Minutes, Color, 1976
National Aeronautics and Space Administration
16mm Film No. 008619/GD Sale $182.50
Videocassette No. 008990/GD Sale $ 65.00

From the vast islands of stars called galaxies, to subatomic particles . . . from cosmic events that occurred billions of years in the past, to microcosmic events in the present that endure for only a billionth of a second . . . here is an exploration of almost inconceivable extremes of size and time. Here is *Universe*. Nominated for an Academy Award (Best Documentary Short Subject, 1977), it has been acclaimed a cinematic triumph. Narrated by William Shatner, this film portrays vividly and with profound eloquence the very essence of an awesome and incredibly violent universe.

☆ WINNER: Blue Ribbon American Film Festival; CINE Golden Eagle; Gold Camera Award/Best of Festival, U.S. Industrial Film Festival; Chris Statuette, Columbus Film Festival; Bronze Medal, San Francisco International Film Festival; First Prize, Cairo International Film Festival

Life?

15 Minutes, Color, 1976
National Aeronautics and Space Administration
16mm Film No. 008118/GD Sale $106.00
Videocassette No. A00389/GD Sale $ 55.00

Can alien environments in our Solar System support life as we know it? As this intriguing film opens, the general characteristics of life are detailed and non-life similarities noted. A number of adaptations are introduced in progression to demonstrate how life has adapted to Earth's conditions . . . how certain organisms can withstand severe environmental insults.

☆ WINNER: Best Instructional Television Program/Best Instructional Design, Southern Education Communications Association; Broadcast Media Award, San Francisco State University Film Festival; Plaque, Biofest International Film Festival; CINE Golden Eagle

Planet Mars

29 Minutes, Color, 1979
National Aeronautics and Space Administration
16mm Film No. A01040/GD Sale $198.00
Videocassette No. A04017/GD Sale $ 65.00

For centuries whenever men looked on Mars through their telescopes, the planet appeared earthlike . . . a planet on which life could possibly exist. Mars, the Red Planet, was given top priority in planetary explorations, and during the last decade we have sent spacecraft to observe and photograph its surface. Here is an intriguing story of the exploration of our celestial neighbor. From the beginning—the early investigation by telescope—to the latest chapter—the landing of the Viking robot—the story unfolds in this NASA film.

☆ WINNER: Bronze Award, International Film & TV Festival of New York

Who's Out There?

28 Minutes, Color, 1975
National Aeronautics and Space Administration
16mm Film No. 009327/GD Sale $194.25
Videocassette No. 008992/GD Sale $ 65.00

Orson Welles is the host and narrator of this extraordinary film, which takes us from the monstrous Martians of his famous 1938 radio broadcast, "The War of the Worlds," through science fiction, to science fact. As entertaining as it is enlightening, *Who's Out There?* is a fascinating presentation of the contemporary scientific conclusion—emerging as a result of recent probes to the planets—that intelligent civilizations exist elsewhere in the universe.

☆ **WINNER: Silver Screen Award, U.S. Industrial Film Festival; Chris Bronze Plaque, Columbus Film Festival**

Eagle Has Landed—The Flight of Apollo 11 (Long Version)

29 Minutes, Color, 1969
National Aeronautics and Space Administration
16mm Film No. 283380/GD *Sale $198.00*
Videocassette No. A00742/GD *Sale $ 65.00*

This account of man's first Moon landing in July, 1969, depicts the principal highlights of the mission from launching through the post-recovery activities of astronauts Armstrong, Aldrin, and Collins—with special emphasis on the initial exploration of the lunar surface. Through television, motion picture, and still photography, the film provides an eyewitness perspective of the momentous Apollo 11 mission.

☆ **WINNER: Gold Camera Award, U.S. Industrial Film Festival; Ionosphere Award, Atlanta International Film Festival; Certificate of Merit, American Science Film Association**

Eagle Has Landed—The Flight of Apollo 11 documents one of the most important achievements of the century.—Photo courtesy of NASA

Earth Sciences/ Nature Studies

Living Waters of the Big Cypress

14 Minutes, Color, 1980
National Park Service
16mm Film No. A02817/GD *Rental $25.00*
Sale $95.75
Videocassette No. A03476/GD *Sale $55.00*

The Big Cypress National Preserve in Florida is a virtual haven for an astounding array of life forms—a study in itself of a perfect ecosystem. You'll see examples of the interdependence between animals and plants, and the progression of life cycles. Fascinating microphotography, subjective cinematography, and on-site sound bring the viewer face to face with wildlife and vegetation rarely visible to the human eye.

☆ **WINNER: Bronze Award, International Film & TV Festival of New York**

Fire and Ice

20 Minutes, Color, 1973
National Park Service
16mm Film No. 010077/GD *Rental $ 25.00*
Sale $153.00
Videocassette No. A00609/GD *Sale $ 55.00*

Formation of Mount Rainier across eons of geological time . . . then gradual erosion of this sleeping volcano as time-lapse photography captures the movement of a sweeping glacier which sculptures and diminishes it.

☆ **WINNER: Certificate of Creative Excellence, U.S. Industrial Film Festival; Trophy of Nations, Trento International Festival of Mountain and Exploration Films; CINE Golden Eagle**

Stone Forest

17 Minutes, Color, 1974
National Park Service
16mm Film No. 010123/GD *Rental $ 25.00*
Sale $12[illegible].50
Videocassette No. A00701/GD *Sale $ 55.00*

Changing moods of the desert and the story of petrification . . . with time-lapse photography detailing the formation of crystals and the process by which fallen trees turn to stone.

☆ **WINNER: CINE Golden Eagle; Gold Camera Award, U.S. Industrial Film Festival; First Prize, Salerno International Film Festival**

Giant Sequoia

17 Minutes, Color, 1979
National Park Service

16mm Film No. A02197/GD	*Rental $ 25.00* *Sale $115.75*
Videocassette No. A02198/GD	*Sale $ 55.00*

The Sequoia trees are monuments of nature—monuments that cover 850,000 acres of the Sequoia National Park located midway between San Francisco and Los Angeles. This film account brings the natural science story of these giant trees up to date—including new material about the roles played by animals in the reproduction of the Sequoia species and the effects of forest fires.

☆ **WINNER: CINE Golden Eagle**

Visit nature's wonders through *Giant Sequoia.*

Killer Bees—Fact or Fantasy

14 Minutes, Color, 1978
Department of Agriculture

16mm Film No. A00365/GD	*Rental $25.00* *Sale $95.50*
Videocassette No. A00740/GD	*Sale $55.00*

Is there a super bee? Is its sting so deadly it could kill a man within seconds? Is it a myth or a mutant? Filmed partially on location in French Guiana, this film mitigates many of the horror tales that have become so popular and highlights the precautionary measures being taken now to minimize problems with the bees—which are expected to arrive in the southern states within fifteen years.

☆ **WINNER: CINE Golden Eagle**

☆ **FINALIST: American Film Festival**

Environmental Issues

One Man's Alaska

27 Minutes, Color, 1977
National Park Service

16mm Film No. 010599/GD	*Rental $ 25.00* *Sale $206.00*
Videocassette No. A00640/GD	*Sale $ 65.00*

A documentary profile of Dick Proenneke (conservationist, wildlife cinematographer) at his wilderness home in the Lake Clark area of Alaska features closeup scenes of native wildlife, dramatic panoramas of the change of seasons, and clips of Proenneke carving his log cabin home out of the wilderness. This man's singular harmony with his environment and with the wildlife he photographs is demonstrated both in picture and in commentary.

☆ **WINNER: Blue Ribbon, American Film Festival; Certificate of Creative Excellence, U.S. Industrial Film Festival; CINE Golden Eagle**

The Global Weather Experiment

28 Minutes, Color, 1980
National Oceanic and Atmospheric Administration
16mm Film No. A03416/GD *Rental $ 25.00*
Sale $191.25
Videocassette No. A03417/GD *Sale $ 65.00*

The interrelated effects of climatic conditions and weather changes all over the world are illustrated in this documentary report on the largest scientific experiment ever attempted. Scientists from 149 countries joined together in an effort to study the truly "global roots" of weather.

☆ **WINNER: Silver Hugo, Chicago Film Festival; CINE Golden Eagle**

Join the international team of scientists carrying out *The Global Weather Experiment.*

Fantastic Yellowstone

25 Minutes, Color, 1979
National Park Service
16mm Film No. A01687/GD *Rental $ 25.00*
Sale $170.75
Videocassette No. A02192/GD *Sale $ 65.00*

Old Faithful, the Grand Canyon, abounding wildlife . . . for years, Yellowstone National Park has offered the country countless gifts of nature. But it has also given the world another kind of gift, one as special as any of its physical offerings: the idea of the national park. Following several expeditions through the breathtaking wilderness, the U.S. Congress in 1872 made Yellowstone the first national park. From that point on, the national park concept flowered across the Nation and overseas.

☆ **WINNER: CINE Golden Eagle**

Amazing Grace

10 Minutes, Color, 1979
National Park Service
16mm Film No. A02168/GD *Rental $25.00*
Sale $68.25
Videocassette No. A02169/GD *Sale $45.00*

Exquisite photography and a lovely, original score convey the essence of the majestic trees of the Sequoia National Park in California. This enchanting look at the giant Sequoia in all seasons gives viewers a chance to enjoy their beauty in the classroom. Communicating through images alone, this lyrical program is well-suited for use in classrooms with hearing-impaired students. Among the towering perennials of the park is the General Sherman tree—the largest living thing in the world.

☆ **WINNER: CINE Golden Eagle**

Century III—Man and His Environment

28 Minutes, Color, 1978
International Communication Agency

16mm Film No. 010471/GD	*Rental $ 44.00*
	Sale $206.00
Videocassette No. A00733/GD	*Sale $ 65.00*

Man's efforts to stabilize the delicate balances of the ecosphere are illustrated here in segments featuring architecture, industrial and urban conservation, solar energy, and working models of small-scale rural self-sufficiency. Mixing lyrical photography and scientific fact, this program points to several areas of conservation research that have far-reaching effects.

☆WINNER: CINE Golden Eagle

The Weather Watchers

15 Minutes, Color, 1977
National Aeronautics and Space Administration

16mm Film No. 010468/GD	*Sale $102.50*
Videocassette No. A04032/GD	*Sale $ 55.00*

Ancient civilizations looked to the mythological gods for protection from the elements. Today, weather is approached scientifically; we use sophisticated devices to record, track, and predict atmospheric activity. Weather satellites serve as eyes in the sky, helping us pinpoint and prepare for storms. This film will complement studies in technology, geography, and meteorology.

☆WINNER: Gold Medal, International Film & TV Festival of Newburry; Diploma, Astrofest, Skollja, Yugoslavia; Gold Award, International Film & TV Festival of New York

The Gifts (Revised)

29 Minutes, Color, 1974
Environmental Protection Agency

16mm Film No. 005070/GD	*Rental $ 25.00*
	Sale $198.00
Videocassette No. A00734/GD	*Sale $ 65.00*

This popular film—which has been seen in the last few years by more than four million viewers across the country—shows the American landscape and what has happened to it during the past two and a half centuries. The title refers to the Nation's legacy of clean water, pure air, and untouched land . . . a legacy threatened by growing pollution. Actor Lorne Greene narrates this penetrating look at what has been sacrificed during our Nation's growth and how it can be salvaged.

☆NOMINATED for an Academy Award, Best Documentary Short Subject

Day of the Killer Tornados

27 Minutes, Color, 1978
Defense Civil Preparedness Agency

16mm Film No. 010669/GD	*Rental $ 25.00*
	Sale $184.25
Videocassette No. A00739/GD	*Sale $ 65.00*
16mm Film No. A00942/GD— Short Version, 14 Minutes	*Rental $ 25.00* *Sale $ 95.50*
Videocassette No. A03065/GD	*Sale $ 5[illegible].00*

Here is the grim, gripping story of the day that 147 deadly twisters swept across Ohio, Kentucky, and Alabama. These fierce funnels devastated large portions of 11 states, killing 315 people along the way. You'll see actual footage of the tornados as they strike Xenia, Cincinnati, and Louisville—and discover how advance preparation and coordination in emergency operating centers can help save lives. This excellent documentary will aid study of civil defense as well as weather.

☆WINNER: CINE Golden Eagle

Energy Concerns

Rethinking Tomorrow

28 Minutes, Color, 1980
Department of Energy

16mm Film No. A03832/GD	*Rental $ 25.00*
	Sale $191.75
Videocassette No. A03833/GD	*Sale $ 65.00*

America's industrial revolution and burgeoning economy was fueled by cheap energy—oil. But what our country con-

sumes in a decade takes nature eons to produce. With the finite nature of fossil fuels now being felt in rapidly escalating costs and decreasing production, energy alternatives must be found. You'll visit communities that have adopted comprehensive conservation programs to effectively reduce energy consumption without sacrificing our quality of life.
☆ WINNER: Bronze Award, Houston International Film Festival; CINE Golden Eagle

Running on Empty—The Fuel Economy Challenge

27 Minutes, Color, 1978
Department of Energy
16mm Film No. A00109/GD *Rental $ 25.00*
Sale $184.25
Videocassette No. A00736/GD *Sale $ 65.00*

Ever since we Americans first fell in love with our cars, we've competed against each other in road rallies to see who could drive the fastest, the farthest, or the smartest. Now the energy crisis and the rising cost of gasoline have given birth to a new kind of road rally—the fuel economy challenge. In an exciting, upbeat film presentation of a special 90-mile road rally, we are introduced to a variety of methods that average drivers in average cars can practice to achieve maximum savings in gasoline.
☆ WINNER: CINE Golden Eagle; Electra Certificate of Recognition, Birmingham International Educational Film Festival

Unconventional Gas Resources

29 Minutes, Color, 1980
Department of Energy
16mm Film No. A04089/GD ***Sale $198.75***
Videocassette No. A04090/GD ***Sale $ 65.00***

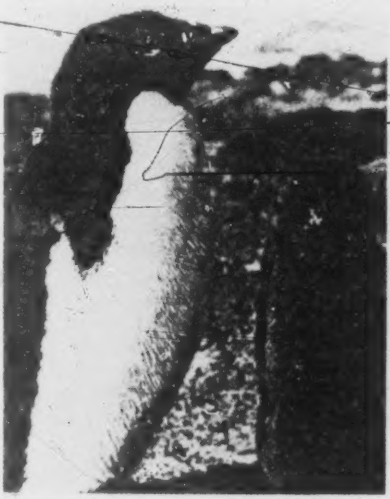
Natural gas—found in tight subsurface rocks—has become increasingly important as our search for new energy resources continues. This program allows you to observe coring operations, test wells, and production activities related to the recovery of methane from coalbeds, geopressured aquifers, eastern gas shales, and western gas sands. Representatives from oil companies, laboratories, government, and educational institutions comment on plans to harness these resources.
☆ WINNER: CINE Golden Eagle

Research and Progress

What About Tomorrow?

19 Minutes, Color, 1978
National Science Foundation
16mm Film No. A01034/GD *Sale $136.50*
Videocassette No. A04035/GD *Sale $ 55.00*

Dick Cavett narrates this look into the research of four scientists who represent the areas of environmental study, physics, agriculture and chemistry. We follow an oceanographer down to the sea floor as he explores the Earth's crust and its



In *Antarctica: Laboratory for Science*, you'll observe the fascinating social behavior of animals.

movement . . . see a special balloon take off to analyze man's effects on the Earth's stratosphere . . . visit an agricultural scientist who is studying the ability of special ferns to multiply crop yields . . . and observe the development of laser power for application in medicine and scientific exploration.

☆ WINNER: CINE Golden Eagle

Antarctica: Laboratory for Science

27 Minutes, Color, 1978
National Science Foundation

16mm Film No. A02205/GD	*Sale $184.25*
Videocassette No. A03963/GD	*Sale $ 65.00*

This intriguing film provides glimpses of scientific research in the Antarctic. Topics explored range from the study of local fish that produce their own adaptive "anti-freeze," which may someday be developed to inoculate crops against killer frosts; the supercontinent theory; animal social behavior; and Earth's inner thermometer.

☆ WINNER: CINE Golden Eagle; Great Prize, Techfilm, Czechoslovakia International Film Congress

The New Industrial Revolution

13 Minutes, Color, 1980
National Science Foundation

16mm Film No. A02809/GD	*Sale $81.75*
Videocassette No. A02810/GD	*Sale $55.00*

A new revolution is taking place—the use of intelligent machines in industry. The futuristic technology that is upon us can be seen in these experiments with computerized machines, mechanical hands, and a process termed the "machine vision module" that enables a machine to "see" what it is doing—systems that are making the modern assembly line more efficient.

☆ WINNER: Red Ribbon, American Film Festival

Keyhole of Eternity

27 Minutes, Color, 1975
National Science Foundation

16mm Film No. A02190/GD	*Rental $ 25.00*	
	Sale $184.25	
Videocassette No. A04002/GD	*Sale $ 65.00*	

As each of us tries to decipher the puzzle of the universe around us, we look to nature to provide clues—and interpret these clues in our own way. Research scientists employ special perspectives as they seek out basic laws of nature. A physicist, oceanographer, molecular biologist, animal behaviorist, and Dr. Carl Sagan, the renowned astronomer, offer their bases for and unique interpretations of our world.

☆ WINNER: Gold Award, International Film & TV Festival of New York

Carl Sagan offers interpretations of our universe in *Keyhole of Eternity.*—Photo courtesy of KCET-TV

both parents bear new feelings. The birth of a baby is also the birth of a parent—the start of a new way of life and the beginning of new responsibilities. This film is about the ways parents prepare for parenthood, focusing on their psychological preparation. It shows that this preparation begins when you are born and intensifies when you are expecting a baby. It will help prospective parents think about the reasons for having a baby as well as the decision about when to have it.

☆WINNER: CINE Golden Eagle

Special Education

Working On Working

29 Minutes, Color, 1979
Bureau of Occupational and Adult Education
16mm Film No. A02631/GD Rental $ 25.00
Sale $198.00
Videocassette No. A02632/GD Sale $ 65.00

The biggest problem the disabled have is other people not accepting them for what they can do. This film accentuates the positive by showing how disabilities can be overcome with patience and understanding. Skeptical employers, reluctant teachers, frustrated parents, and fellow students are seen changing their attitudes to the disabled students and workers as they make progress in the vocational training classroom and working environment.

☆WINNER: Gold Award, International Film & TV Festival of New York

Wherever We Find Them

29 Minutes, Color, 1979
Veterans Administration
16mm Film No. A02138/GD Sale $198.00
Videocassette No. A02282/GD Sale $ 65.00

Swimming, skiing, horseback riding—these activities offer enjoyment to millions, but present a special challenge to the handicapped. This action-packed documentary features handicapped men and women of all ages participating—and competing—in almost every type of athletic and recreational activity. As team members or as individuals, these people aim for mastery in their chosen fields. They disclose their personal philosophies towards their handicapping conditions, while showing how they use their abilities to overcome their disabilities.

☆WINNER: CINE Golden Eagle

Careers

Very Enterprising Women

15 Minutes, Color, 1980
Small Business Administration
16mm Film No. A04078/GD Rental $25.00
Sale $102.75
Videocassette No. A04079/GD Sale $55.00

The chances of any new business surviving more than five years are one in four—but the five women featured in this motivational documentary have succeeded against these odds. Their energy, imagination, and hard work have led to accomplishments in enterprises as varied as market research and truck farming.

☆WINNER: CINE Golden Eagle

Feelings . . . A Way To Better Letter Writing

11 Minutes, Color, 1978
Veterans Administration
16mm Film No. A02603/GD Rental $25.00
Sale $75.00
Videocassette No. A02604/GD Sale $55.00

There are two styles of letter writing—one is clear, understandable, and to the point; the other wordy, pedantic, and complicated. Of course, both the writer and the reader would prefer the first style—but how do you do it? Through humorous sequences this award-winning presentation shows you how you can learn techniques to improve your correspondence.

☆WINNER: CINE Golden Eagle

World Cultures

Yanomama—A Multi-Disciplinary Study

45 Minutes, Color, 1971
Atomic Energy Commission
16mm Film No. 824625/GD — *Rental $ 35.00*
Sale $307.00
Videocassette No. A03738/GD — *Sale $ 85.00*

Not long ago, anthropologists for the first time established relations with the Yanomama tribes in southern Venezuela and northern Brazil. These researchers studied the social and biological structures of primitive peoples and how they are influenced by their isolated environment. Here you will observe researchers as they interact with the natives, examining the social customs, beliefs, and health of the Yanomama—people who may present us with the last opportunity to study firsthand primitive man.

☆WINNER: Red Ribbon, American Film Festival; CINE Golden Eagle
☆FINALIST: International Congress of Human Genetics, Paris; National Educational Film Festival, Oakland; Teheran International Educational Film Festival

The Feast

29 Minutes, Color, 1970
Atomic Energy Commission
16mm Film No. 320860/GD — *Rental $ 25.00*
Sale $198.00
Videocassette No. A03798/GD — *Sale $ 65.00*

With minimal interpretation, this film study allows us to observe natives of one Yanomama village renew their alliance with another. The tribal celebration includes an elaborate dance, presentation of gifts, and the sharing of food and hallucinogenic drugs. Anthropology students can gain an intimate view of a foreign culture—one that may reflect our past.

☆WINNER: Grand Prize Trophy, Brussels International Festival on Tourism & Folklore; CINE Golden Eagle; Blue Ribbon, American Film Festival; First Place, International Festival of Sociological and Ethnographic Films

Indian Pottery of San Ildefonso

27 Minutes, Color, 1972
National Park Service
16mm Film No. 010097/GD — *Rental $ 25.00*
Sale $206.00
Videocassette No. A00628/GD — *Sale $ 65.00*

Maria Martinez, noted Indian pottery maker, demonstrates the traditional Indian ways, beginning with the spreading of sacred corn before the clay is gathered. Also shown are the mixing of clay, construction of pottery, hand decorating, and building of the firing mound.

☆WINNER: Certificate of Creative Excellence, U.S. Industrial Film Festival; Certificate, Salerno International Film Festival; CINE Golden Eagle

Arts and Humanities

The Smithsonian Institution, with S. Dillon Ripley, Secretary

24 Minutes, Color, 1977
Smithsonian Institution
16mm Film No. A00378/GD Rental $ 25.00
Sale $164.00
Videocassette No. A00732/GD Sale $ 65.00

What is a museum . . . what makes the Smithsonian a unique facility? S. Dillon Ripley, the present Secretary of the Institution, is the host-narrator of this fascinating look at the artists, craftsmen, scholars, and research scientists who guide the course of this "open university." Highlights from individual collections and exhibitions are presented too—ranging from the museums and zoo in Washington, D.C. to the Astrophysical Observatory on Mt. Hopkins and the Tropical Research Institute in Panama.

☆WINNER: CINE Golden Eagle

Celebrating a Century: The 1876 Philadelphia Centennial Exhibition

28 Minutes, Color, 1976
Smithsonian Institution
16mm Film No. A00377/GD Rental $ 25.00
Sale $191.25
Videocassette No. A00730/GD Sale $ 65.00

Narrated by James Whitmore, this fascinating journey back in time demonstrates how our ancestors viewed life in America after the first hundred years of the Republic. It depicts the preparations for the 1876 Centennial Exposition in Philadelphia and the colorful opening day ceremonies led by President Ulysses S. Grant and the Emperor of Brazil, Dom Pedro.

☆WINNER: CINE Golden Eagle; Chris Bronze Plaque, Columbus Film Festival; Special Jury Plaque, Festival of the Americas

A Man's Reach Should Exceed His Grasp

24 Minutes, Color, 1972
National Aeronautics and Space Administration
16mm Film No. 002124/GD Sale $164.00
Videocassette No. 008991/GD Sale $ 65.00

Here is the story of man's reach for a new freedom . . . the story of flight. From the Wright Brothers flight at Kitty Hawk to the landing on the Moon and future missions to the planets, this film depicts the fulfillment of man's ancient dream of flight. The voices of scientists and statements by writers, poets, and philosophers document man's unending quest for knowledge, with multiple images used throughout to emphasize the creative role of research. Narrated by Burgess Meredith.

☆WINNER: Silver Phoenix, Atlanta International Film Festival; First Prize, Paris International Festival of Aeronautics and Space Films; Certificate of Creative Excellence, U.S. Industrial Film Festival; CINE Golden Eagle

Hirshhorn Museum and Sculpture Garden

10 Minutes, Color, 1978
International Communication Agency
16mm Film No. 010472/GD Rental $30.00
Sale $88.25
Videocassette No. A00731/GD Sale $45.00

"Come with me today, away from the things of everyday, away from streets and pots and telephones . . . today will be filled with visions, rich with colors—today will be filled with dreams." Over the years, Joseph H. Hirshhorn assembled what is considered by many to be one of the most diverse and impressive private art collections in America; when the collection was donated to the U.S. Government in 1966, one of our foremost public art museums was born. Here is an opportunity to visit and view this esteemed collection of paintings, sculpture, drawings, and prints.

☆WINNER: CINE Golden Eagle

Profiles

Reflections: Margaret Mead

58 Minutes, Color, 1976
International Communication Agency
16mm Film No. A02096/GD *Rental $ 40.00*
Sale $396.25
Videocassette No. A02098/GD *Sale $ 95.00*

"When I entered anthropology our major task was to rescue vanishing cultures . . . If we let one language disappear, we're poorer, and we could never invent it again." Margaret Mead—the internationally recognized writer, teacher, and social critic—helped the world discover and appreciate the diversity of its peoples. Here she reflects on her life in a world context, sharing with us the experiences that molded her perspective on cultural advancements, technological change, and family life—and those that fueled her hope for humanity's survival. This inspiring program includes fascinating footage of the late anthropologist's last visit to the cultures she had studied years before.

☆ **FINALIST: American Film Festival**

Copland Portrait

29 Minutes, Color, 1975
International Communication Agency
16mm Film No. 008407/GD *Rental $ 44.00*
Sale $206.00
Videocassette No. 008750/GD *Sale $ 65.00*

"For half a century, in symphony, ballet, song, and opera, he has written music that is distinctly American . . . For half a century he has been America's most acclaimed composer." This intimate and sensitive portrait of Aaron Copland offers his insights and reflections on American musical history—as well as excerpts from his works, which bear out the testimony in his honor.

☆ **WINNER: Blue Ribbon, American Film Festival; Blue Ribbon, Birmingham International Educational Film Festival; CINE Golden Eagle**

Reflections: George Meany

52 Minutes, Color, 1979
International Communication Agency
16mm Film No. A02185/GD *Rental $ 35.00*
Sale $355.00
Videocassette No. A02187/GD *Sale $ 95.00*

Blunt and determined, the late George Meany acted as a guiding force in the Nation's economic affairs, social legislation, and international politics. Known as "the leader of the American labor movement," Meany helped bring about the merger of the American Federation of Labor (AFL) and the Congress of Industrial Organizations (CIO) in 1955 after 20 years of bitter rivalry. This program combines in-depth interviews and rare documentary footage to explore early labor organizing efforts, the rise of collective bargaining, and the tumultuous years after World War II that led to the AFL-CIO merger. "An enlightening and well illustrated film record of labor unions in the United States and one man whose presence changed for all time the life of the working man"—*Landers Film Reviews* (September/October 1980).

☆ **WINNER: Certificate of Creative Excellence, U.S. Industrial Film Festival; CINE Golden Eagle**

Reflections: George Meany tells the story of "the leader of the American labor movement."

Roy Wilkins—The Right To Dignity

20 Minutes, Color, 1978
International Communication Agency
16mm Film No. A00935/GD *Rental $ 25.00*
Sale $136.50
Videocassette No. A01188/GD *Sale $ 55.00*

Narrated by Sidney Poitier, here is the dramatic account of Wilkins' long, productive career with the National Association for the Advancement of Colored People (NAACP). Highlighted is this important activist's role in the 1954 Supreme Court decision. *Brown v. Board of Education*—the historic ruling that dramatically changed public education and the social history of the United States—and in the landmark civil rights legislation of the 1960's. Participating as commentators on Roy Wilkins as a man and as a leader are Clarence Mitchell, former director of the Washington office of the NAACP, and Benjamin Hooks, executive director of the association.

☆ WINNER: Bronze Award, International Film & TV Festival of New York

Mobile By Alexander Calder

24 Minutes, Color, 1980
National Gallery of Art
16mm Film No. A03683/GD *Sale $164.50*
Videocassette No. A03684/GD *Sale $ 65.00*

Whimsy . . . color . . . balance . . . movement—Alexander Calder's mobile, suspended in the National Gallery of Art's East Wing, was the first piece of art installed in the new building and the last major work of its creator. Here is the story of the innovator of the mobile, and the record of the collaboration of artist, museum staff, and craftsmen in the giant structure's creation.

☆ WINNER: CINE Golden Eagle

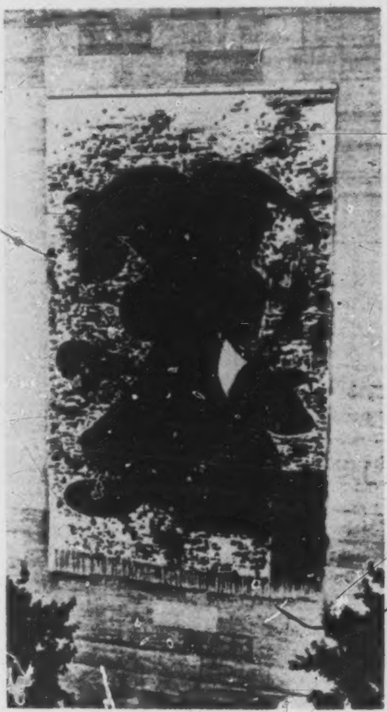
Femme/Woman—A Tapestry By Joan Miró

15 Minutes, Color, 1980
National Gallery of Art
16mm Film No. A03814/GD *Sale $102.75*
Videocassette No. A03815/GD *Sale $ 55.00*

In the East Wing of the National Gallery of Art hangs a mammoth tapestry weighing more than a ton. "Femme/Woman" represents the mastery of painter Joan Miró and weaver Josep Royo. Filmmakers followed the progress of the work through the years, giving viewers a first-hand look at the elaborate weaving process, shipment of the massive tapestry from its oversized loom in Tarragona, Spain, and its display in the East Wing.

☆ WINNER: CINE Golden Eagle

Trace the creation of *Femme/Woman—A Tapestry By Joan Miró.*



Social Studies

From Where I Sit (New Version)

26 Minutes, Color, 1979
U.S. Department of State
16mm Film No. A01079/GD *Sale $177.25*
Videocassette No. A01982/GD *Sale $ 65.00*

People of various ages and socioeconomic backgrounds express their opinions on a number of national issues—and demonstrate that every perspective must be considered in the planning of American foreign policy. The dialogue underscores the point that only through understanding of all aspects of any problem can an effective solution be achieved. Students in civics, government, social studies, sociology, psychology, contemporary social issues, and many other classes can gain some important insights through this excellent production. This program is especially timely in light of current world crises.

☆ WINNER: CINE Golden Eagle; Honorable Mention, American Film Festival

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History

Castle on the Plain

31 Minutes, Color, 1976
National Park Service
16mm Film No. 010253/GD *Rental $ 25.00*
Sale $235.50
Videocassette No. A00595/GD *Sale $ 75.00*

Here is the epic story of one family's involvement in the tumultuous past of the Southwest. It is a story of traders . . . of Indians . . . of mountain men . . . of Texas and Mexico . . . of war and peace . . . of man's interaction with man. *Castle on the Plain* uses "Bent's Fort" as a springboard to explore all that went before.

☆ WINNER: Silver Award, International Film & TV Festival of New York; CINE Golden Eagle

Golden Spike

21 Minutes, Color, 1969
National Park Service
16mm Film No. 010089/GD *Rental $ 25.00*
Sale $159.00
Videocassette No. A00580/GD *Sale $ 65.00*

Struggling against Indians, blizzards, and rugged terrain, laborers drove the final spike of America's first transcontinental railroad at Promontory Point, Utah, in 1869. This reenactment traces the construction of the railroad, which spurred the industrialization of the young Nation and foretold the fate of the American Indian.

☆ WINNER: Chris Bronze Plaque, Columbus Film Festival; Best Documentary Film, National Cowboy Hall of Fame

The Americans, 1776

28 Minutes, Color, 1975
National Park Service
16mm Film No. 010059/GD *Rental $ 25.00*
Sale $211.75
Videocassette No. A00588/GD *Sale $ 65.00*

Here is an authentic view of everyday life during the time of the American Revolution. The crafts, ways of life, and differences of attitudes among various types of people living in the Colonies.

☆ FINALIST: American Film Festival

The Granite Lady

28 Minutes, Color, 1974
Department of the Treasury
16mm Film No. A01930/GD *Rental $ 25.00*
Sale $191.25
Videocassette No. A04148/GD *Sale $ 65.00*

The excitement of the Gold Rush, the terror of the San Francisco earthquake and fire, and the impact of the Old Mint—the Granite Lady—on America's history can again be experienced through this entertaining and educational film. Actress Mercedes McCambridge dramatically narrates the story of the creation, abandonment, preservation, and restoration of the Old Mint, which was reopened in 1973 as a national landmark. Restored to its original 1874 grandeur, the Old Mint houses exhibits such as a miner's cabin, early minting equipment, and a 1869 coin press.

☆ WINNER: CINE Golden Eagle

Hymn of the Nations

28 Minutes, b&w, 1944
Office of War Information, Overseas Branch
16mm Film No. 414850/GD *Rental $ 20.00*
Sale $106.00
Videocassette No. A00768/GD *Sale $ 65.00*

In this rare cinematic document, Arturo Toscanini conducts the NBC Symphony Orchestra in the overture of Verdi's "La Forza del Destino" and "Hymn of the Nations." For this radio broadcast—which marked the overthrow of the Fascists in his native Italy—the conductor re-scored Verdi's famous "Hymn" to include the British, Italian, French, and American national anthems. The result is a truly magnificent call to international peace and brotherhood. *Hymn of the Nations* remains a celebration of a man, his music, and his love of freedom.

☆ NOMINATED for an Academy Award, Best Documentary Short Subject

Arturo Toscanini conducts a musical call for international peace in *Hymn of the Nations*.—Photo courtesy of Wide World Photos

Prelude To War

54 Minutes, b&w, 1942
U.S. War Department
16mm Film No. 003082/GD *Rental $ 30.00*
Sale $206.00
Videocassette No. A00728/GD *Sale $ 95.00*

During World War II noted Hollywood director Frank Capra was enlisted by the War Department to film orientation programs that would maintain morale and instill loyalty in a civilian army. The first film of his highly acclaimed series, *Why We Fight*, portrays the events leading up to the war—Japanese attacks on Manchuria, the rise of fascism in Germany and Italy, and the lack of military preparedness in the United States. Screened at the Athens International Film Festival in 1980.

☆ WINNER: Academy Award, Best Documentary Feature, 1942

This film has been declared obsolete for use within the Department of Defense but may have content value for educational use. For information on other films in the ***Why We Fight*** *series, please contact the National AudioVisual Center.*

About the National AudioVisual Center

These award-winning programs have been selected from the National AudioVisual Center's extensive library of films, videocassettes, sound slide sets, filmstrips, and other media. The Center is the central source for more than 13,000 programs produced by Federal agencies on history, humanities, science, education, and other subjects. To learn more about the Center's collection and services, please write:

National AudioVisual Center
National Archives and Records Service
General Services Administration
Reference Section GD
Washington, DC 20409
. . . or call: (301) 763-1896

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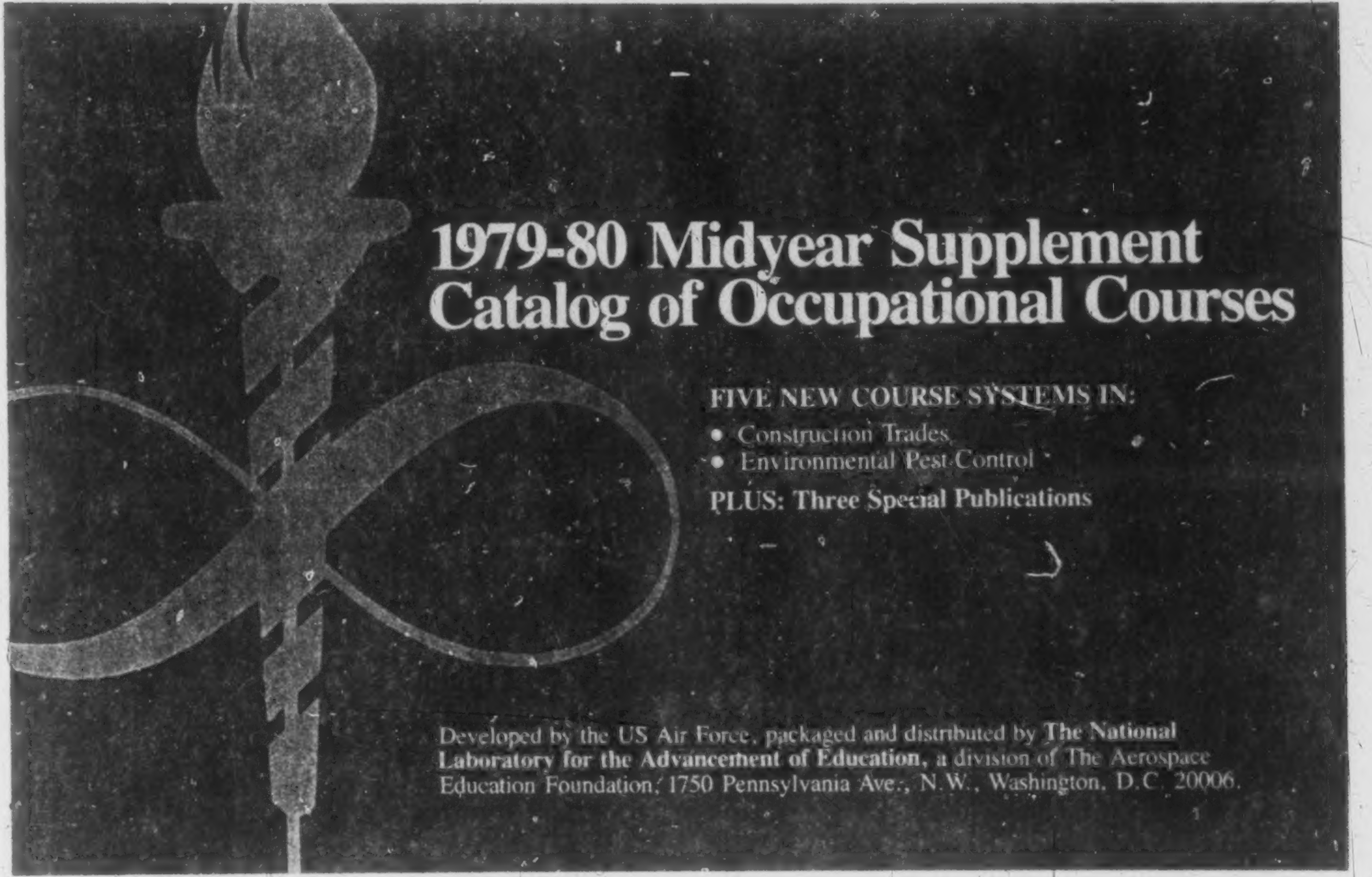

1979-80 Midyear Supplement Catalog of Occupational Courses

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State Board for Technical and Comprehensive
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"I am presently using your material for Electronics and have found it to be the most outstanding material on the market."

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JAN 17 1979

LANGUAGE LEARNING

- Schedule of Courses
  for January-August, 1979
- Individual Instruction
- Group Instruction
- Intensive Language Programs
- On-Site Training
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World Trade Institute Language School

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The World Trade Institute at the World Trade Center

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EDWARD J. MEELL
PRESIDENT

July 6, 1981

Honorable Senator John Heinz
United States Senate
Washington, DC 20510

Dear Senator Heinz:

On Wednesday, June 24 I had the privilege of testifying before Senator S. I. Hayakawa's Subcommittee on Advocacy and the Future of Small Business. Senator Hayakawa had called the hearing in order to explore an area of increasing concern to those of us who are in the small business sector of the economy ... actually a rather large sector of the economy in terms of employment and innovation.

Over the past several decades, many small businesses in this country have suffered from direct and indirect competition from the U.S. Government and government at all levels. It has become such a critical issue that many people who suffer from this competition are now working to make everyone aware of the size and complexity of the problem.

For your information I am enclosing two (2) items that I hope will give you and your staff some background on this problem. The first is a copy of my testimony before Senator Hayakawa's Subcommittee. The second is a report published in March, 1980, which summarizes the activities of a Task Group I served on for the Small Business Administration; a Task Group that addressed government competition with the small business community.

Once you and your staff have had a chance to read and digest these items, I would appreciate you doing two things:

1. Please support Senator Hayakawa's Senate Joint Resolution 93. This resolution endorses the concept that the government should rely on the private sector for its goods and services. It would be nice if you even became a co-sponsor.
2. Please let me know your reactions and position on this issue and what you can do to help up insure that the government does rely more on the private sector for these goods and services.

Thank you for your consideration of this issue and for the fine job you are doing in representing Pennsylvania.

Cordially yours,

Edward J. Meell

Edward J. Meell

EJM:jl
cc: Senator S. I. Hayakawa

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EDWARD J. MEELL
PRESIDENT

July 6, 1981

Honorable Senator Arlen Spector
United States Senate
Washington, DC 20510

Dear Senator Spector:

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Thank you for your consideration of this issue and for the fine job you are doing in representing Pennsylvania.

Cordially yours,

Edward J. Meell

Edward J. Meell

EJM:jl
cc: Senator S. I. Hayakawa

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EDWARD J. MEELL
PRESIDENT

July 6, 1981

Honorable Representative James Coyne
United States House of Representatives
Washington, DC 20515

Dear Representative Coyne:

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Once you and your staff have had a chance to read and digest these items, I would appreciate you doing two things:

1. Please support Congressman David Dreier's House Joint Resolution, a companion to Senator Hayakawa's SJR 93. This resolution endorses the concept that government should rely on the private sector for its goods and services. It would be nice if you even became a co-sponsor.
2. Please let me know your reactions and position on this issue and what you can do to help us on this matter.

Thank you for your consideration of this issue and for the fine job you are doing in representing Pennsylvania.

Cordially yours,

Edward J. Meell

Edward J. Meell

EJM:jl

cc. Senator S. I. Hayakawa

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 30, 1981

Mr. George Ostrowski, President
Business Management Research Associates, Inc.
Crystal Mall I, Suite 708
1911 Jefferson Davis Highway
Arlington, Virginia 22202

Dear Mr. Ostrowski:

I personally would like to thank you for testifying before the Subcommittee on Advocacy and the Future of Small Business on Wednesday, June 24, 1981. I believe that our initial investigation into the extent of government competition with small business was both enlightening and thought-provoking. I am looking forward to further, in-depth hearings on this important issue.

As I mentioned during the hearing, I did not have the opportunity to pose all of the questions I had hoped to ask. Accordingly, I have enclosed additional questions and would very much appreciate your written response for the official hearing record. Any additional comments you have for the record are welcome also.

If you have any questions about these materials, please do not hesitate to call Kimberly Elliott with the Small Business Committee at (202) 224-3840 or Grace Hussie on my personal staff at (202) 224-3841.

Again, thank you for your participation in what I believe was a very productive hearing.

Sincerely,

S. I. HAYAKAWA
Chairman
Subcommittee on Advocacy and
the Future of Small Business

BM
RA

BUSINESS MANAGEMENT RESEARCH ASSOCIATES, INC.

July 7, 1981

Honorable S. I. Hayakawa
Chairman
Subcommittee on Advocacy and
the Future of Small Business
Committee on Small Business
United States Senate
Washington, DC 20510

Dear Senator Hayakawa:

My response to your questions of June 30, 1981, are attached.

Thank you for the opportunity to testify on behalf of small business. I will be pleased to be of continuous service to your subcommittee, particularly with respect to the acquisition and distribution of commercial products.

Sincerely,

Geo. S. Ostrowski

George S. Ostrowski
President

Attachment

SUITE 708, CRYSTAL MALL ONE 1911 JEFFERSON DAVIS HIGHWAY ARLINGTON, VIRGINIA 22202 703-979-4360

RESPONSE TO QUESTIONS RAISED

1. Is the purchase and distribution of commercial products included within the scope of OMB Circular A-76?

   Response: The title and subject of A-76 appears to include purchase and distribution of commercial products but in practice A-76 only applies to performance of technical services and manufacture of commercial products. However, the policies and principles of A-76 apply equally to purchase and distribution of commercial products.

2. Can commercial distribution contracts be set-aside for small businesses?

   Response: There is a problem with contracts to provide total parts and supplies to support an operational function. Most of these contracts are with small businesses in the local area but they cannot be set-aside because some of the material is only made by large businesses and the set-aside requirement is for total small business manufacture.

3. How can the problem you outline in your statement be resolved?

   Response: The Small Business Administration already has exceptions for construction contracting and services so I would recommend that supply contracts for support of an operational function also be excepted from the requirement for furnishing 100% small business manufactured products.

4. What other procedures can be used to provide direct delivery from commercial sources?

   Response: Small purchase procedures are used throughout the Government for a wide range of products, but these are individually negotiated purchases that are also quite costly to handle. The Commission found that the General Services Administration's multiple award schedule program was one of the most economical centrally managed techniques. This program has been criticized because the prices are not as low as for depot deliveries, but the savings in cost by direct delivery to a wide range of users makes the program very cost effective.

5. Did the Commission on Government Procurement have any recommendations on how to make better use of commercial distribution channels?

   Response: The Commission made several recommendations that have been the basis for current OMB policy. One recommendation that has not been implemented called for full cost recovery on all interagency supply transactions. This would require the General Services Administration and the Defense Logistics Agency to identify the cost of the purchase and warehouse services they provide and add it to the item price on requisitions. They would then operate on the same basis as industrial wholesalers. It would also give depot managers an incentive to keep the costs in control since total Government distribution costs could easily be compared with those of industry.

6. Do you believe that the OMB policies and guidelines will be effective in making better use of commercial distribution channels?

   Response: Yes, they will eventually be effective but the agencies will have to take action to implement the policy. The Department of Defense is the only agency I know of that has developed an implementation manual, but it has not yet been issued. Your resolution will provide national policy that will strengthen the OMB policy and hasten implementation.

7. Do you have any personal experience with government competition that you would like to relate to the Subcommittee?

   Response: My testimony has been directed to Government competition in purchase and distribution of commercial products. However, I would like to give you two examples of indirect Government competition in contracting for business research that we have experienced as a small business.

   The first was competition with a nonprofit activity to research the use of Government contracts as an incentive to improve technology in commercial products. The contract was given to a nonprofit activity at a higher cost than we proposed, on the basis that they had several PhDs that could be assigned to the project. Within a week after award the nonprofit came to us for free assistance in the contracting area. We offered to perform the contracting portion of the work but our offer was not accepted. After an expenditure of several million dollars by the nonprofit, the project was terminated without the benefit of a useful product.

   My second example involves sole source contracting by the Government with a minority firm to perform research on use of functional specifications in purchase of telecommunications systems and services. We did the preliminary study on a competitive basis but we were not allowed to compete with the minority firm on the basic study. After sole source award the minority firm came to us for assistance since we wrote the preliminary report. We accepted a subcontract with the minority firm but the final results as reported by the prime contractor were marginal and not as useful as if the contract would have been awarded competitively.

Senator HAYAKAWA. The next witnesses will be the Honorable Donald Sowle, Administrator, Office of Federal Procurement Policy, Office of Management and Budget, and Mr. Clifford I. Gould, Director, Federal Personnel and Compensation Division, General Accounting Office.

Mr. Sowle, let me start by congratulating you on your recent confirmation. We are delighted to have you serving in that capacity. I think it will be beneficial for the small business community.

At this point, Mr. Sowle, I shall welcome your testimony.

STATEMENT OF HON. DONALD E. SOWLE, ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET, WASHINGTON, D.C., ACCOMPANIED BY DARLEEN DRUYUN, DEPUTY ASSISTANT ADMINISTRATOR, MAJOR SYSTEMS ACQUISITIONS AND PROCUREMENT STRATEGIES

Mr. SOWLE. Thank you very much, Mr. Chairman.

I would like to introduce Darleen Druyun, who, among other important duties in the Office of Federal Procurement Policy, is the one who is responsible for the OMB policy under A-76.

Mr. Chairman, we thank you this morning for inviting us here today. I am pleased to present our views on the proposed joint resolution to clarify and reaffirm the basic policy of the Government to rely on the competitive private enterprise for needed goods and services.

At the outset, let me state that this administration strongly supports a general policy of reliance on the competitive private enterprise system to achieve a more economic and efficient mode of Government. We therefore will welcome a clear statement of intent by the Congress in support of this reemphasized policy of the executive branch.

The policy, as you know, has been applied unevenly over several administrations. It is now time to make it work. We fully subscribe to the entire preamble to the resolution.

On the first point, the function of Government is to establish Federal policies and manage Federal programs efficiently and effectively. In the choice of ways to accomplish this end, we believe that the provision of reliance on the private sector for the goods and services that the Government needs has been, by past experience, a responsive, cost effective, and dependable means to perform sensitive and important work.

Second, we endorse the statement that the private enterprise system consisting of businesses, both small and large, is the primary source of our national economic strength. This country has traditionally looked to the private sector to pave economic paths because of its willingness to take risks, seek innovative solutions to new needs and old problems, reduce costs, and create and use new technology.

In this respect, business adds to the Federal, State, and local tax revenues instead of using the revenues, which is the case when Government provides its own needed goods and services.

In addition, competitive procurements fostor efficiency, economy, and increased productivity in the Federal Government. We estimate that the Government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion and a capital investment of a similar amount.

The vast majority of these activities have never been subjected to competition. Available statistics indicate that we could save at least 20 percent of our operating costs if these activities were competed and the private sector costs weighed against the cost of performing the same work in-house.

Mr. Chairman, as an aside, these are estimates. The estimate we got of the 20 percent is based on data solely from the Department of Defense. This may vary a little from other estimates you may hear.

Finally, this administration fully supports the democratic form of free enterprise. As such, we believe that the private enterprise system must be fostered so that it will survive, grow, and continue to be profitable.

Meeting these objectives is severely hampered when the Government openly competes with the private sector. Opportunities for growth are stymied along with profits that contribute to the national economy by providing capital investment opportunities, new jobs, individual initiatives, and tax revenues to pay for our necessary Government functions.

We endorse these precepts with full recognition that our Federal employees must also receive fair treatment. The administration's executive branch policy in this area fully recognizes this by encouraging agencies to streamline their operations for maximum efficiency before undergoing cost comparison studies, by requiring agencies to give priority consideration for placement in other Government positions to those Federal employees displaced by decisions to convert in-house operations to a contract mode of operation, and by requiring contractors to give affected Federal employees the right of first refusal for jobs under a contract.

I am pleased to report that these policy provisions are working well, particularly when Government employees fully understand these provisions.

In summation, the joint resolution, as introduced, is a vigorous and welcome reaffirmation of the importance of the private sector and our free enterprise system that has made this country strong. We believe it provides timely support for this administration's quest for a new revitalized approach to strengthening this country's economy. Economy and efficiency in Government and reward of the private sector for initiative and productivity are necessary ingredients in our formula for economic renewal.

Mr. Chairman, I hope my comments have been helpful in explaining the administration's position on the joint resolution and the promise it holds for more effective Government.

I will be pleased to answer questions when we get to that point, sir.

[The prepared statement of Mr. Sowle follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

HOLD FOR RELEASE UNTIL DELIVERY
Expected at 10:00 a.m., June 24, 1981

STATEMENT OF DONALD E. SOWLE
ADMINISTRATOR
OFFICE OF FEDERAL PROCUREMENT POLICY
OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
SUBCOMMITTEE ON ADVOCACY AND THE FUTURE
OF SMALL BUSINESS
SENATE SELECT COMMITTEE ON SMALL BUSINESS

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

THANK YOU FOR INVITING ME HERE TODAY. I WOULD BE PLEASED TO PRESENT OUR VIEWS ON THE PROPOSED JOINT RESOLUTION TO CLARIFY AND REAFFIRM THE BASIC POLICY OF THE GOVERNMENT TO RELY ON COMPETITIVE PRIVATE ENTERPRISE TO PROVIDE NEEDED GOODS AND SERVICES. AT THE OUTSET AND BEFORE FURTHER COMMENT, LET ME STATE THAT THIS ADMINISTRATION STRONGLY SUPPORTS A GENERAL POLICY OF RELIANCE ON THE COMPETITIVE PRIVATE ENTERPRISE SYSTEM TO ACHIEVE A MORE ECONOMIC AND EFFICIENT MODE OF GOVERNMENT. WE, THEREFORE, WILL WELCOME A CLEAR STATEMENT OF INTENT BY THE CONGRESS IN SUPPORT OF THIS REEMPHASIZED POLICY OF THE EXECUTIVE BRANCH. THIS POLICY, AS YOU KNOW, HAS BEEN APPLIED UNEVENLY OVER SEVERAL ADMINISTRATIONS, AND IT IS NOW TIME TO MAKE IT WORK.

WE FULLY SUBSCRIBE TO THE ENTIRE PREAMBLE TO THE RESOLUTION. ON THE FIRST POINT, THE FUNCTION OF THE GOVERNMENT IS TO ESTABLISH FEDERAL POLICIES AND MANAGE FEDERAL PROGRAMS EFFICIENTLY AND EFFECTIVELY. IN THE CHOICE OF WAYS TO ACCOMPLISH THIS END, WE BELIEVE THAT THE PROVISION OF RELIANCE ON THE PRIVATE SECTOR FOR THE GOODS AND SERVICES THE GOVERNMENT NEEDS HAS BEEN, BY PAST EXPERIENCE, A RESPONSIVE, COST EFFECTIVE, AND DEPENDABLE MEANS TO PERFORM SENSITIVE AND IMPORTANT WORK.

SECONDLY, WE ENDORSE THE STATEMENT THAT THE PRIVATE ENTERPRISE SYSTEM CONSISTING OF BUSINESSES, BOTH SMALL AND LARGE, IS THE PRIMARY SOURCE OF NATIONAL ECONOMIC STRENGTH. THIS COUNTRY HAS TRADITIONALLY LOOKED TO THE PRIVATE SECTOR TO PAVE ECONOMIC PATHS BECAUSE OF ITS WILLINGNESS TO TAKE RISKS, SEEK INNOVATIVE SOLUTIONS TO NEW NEEDS AND OLD PROBLEMS, REDUCE COSTS, AND CREATE AND USE NEW TECHNOLOGY. IN THIS RESPECT, BUSINESS ADDS TO THE FEDERAL, STATE, AND LOCAL TAX REVENUES INSTEAD OF USING THE REVENUES -- WHICH IS THE CASE WHEN THE GOVERNMENT PROVIDES ITS OWN NEEDED GOODS AND SERVICES.

FURTHER, COMPETITIVE PROCUREMENTS FOSTER EFFICIENCY, ECONOMY, AND INCREASED PRODUCTIVITY IN THE FEDERAL GOVERNMENT. WE ESTIMATE THAT THE GOVERNMENT CURRENTLY OPERATES THOUSANDS OF COMMERCIAL OR INDUSTRIAL ACTIVITIES WITH AN ANNUAL OPERATING COST IN EXCESS OF $20 BILLION AND A CAPITAL INVESTMENT OF SIMILAR

AMOUNT. THE VAST MAJORITY OF THESE ACTIVITIES HAS NEVER BEEN SUBJECTED TO COMPETITION. AVAILABLE STATISTICS INDICATE THAT WE COULD SAVE AT LEAST 20 PERCENT OF OPERATING COSTS IF THESE ACTIVITIES WERE COMPETED, AND THE PRIVATE SECTOR COST WEIGHED AGAINST THE COST OF PERFORMING THE SAME WORK IN-HOUSE.

FINALLY, THIS ADMINISTRATION FULLY SUPPORTS THE DEMOCRATIC FORM OF FREE ENTERPRISE. AS SUCH, WE BELIEVE THAT THE PRIVATE ENTERPRISE SYSTEM MUST BE FOSTERED SO THAT IT WILL SURVIVE, GROW, AND CONTINUE TO BE PROFITABLE. MEETING THESE OBJECTIVES IS SEVERELY HAMPERED WHEN THE GOVERNMENT OPENLY COMPETES WITH THE PRIVATE SECTOR. OPPORTUNITIES FOR GROWTH ARE STYMIED ALONG WITH THE PROFITS THAT CONTRIBUTE TO THE NATIONAL ECONOMY BY PROVIDING CAPITAL INVESTMENT OPPORTUNITIES, NEW JOBS, INDIVIDUAL INITIATIVES AND TAX REVENUES TO PAY FOR GOVERNMENT FUNCTIONS.

WE ENDORSE THESE PRECEPTS WITH FULL RECOGNITION THAT OUR FEDERAL EMPLOYEES MUST ALSO RECEIVE FAIR TREATMENT. THE ADMINISTRATION'S EXECUTIVE BRANCH POLICY IN THIS AREA FULLY RECOGNIZES THIS BY:

- ENCOURAGING AGENCIES TO STREAMLINE THEIR OPERATIONS FOR MAXIMUM EFFICIENCY BEFORE UNDERGOING COST COMPARISON STUDIES;

- REQUIRING AGENCIES TO GIVE PRIORITY CONSIDERATION FOR PLACEMENT IN OTHER GOVERNMENT POSITIONS THOSE FEDERAL EMPLOYEES DISPLACED BY DECISIONS TO CONVERT IN-HOUSE

OPERATIONS TO A CONTRACT MODE OF OPERATION; AND

- REQUIRING CONTRACTORS TO GIVE AFFECTED FEDERAL EMPLOYEES THE RIGHT OF FIRST REFUSAL FOR JOBS UNDER A CONTRACT.

I AM PLEASED TO REPORT THAT THESE POLICY PROVISIONS ARE WORKING VERY WELL, PARTICULARLY WHEN GOVERNMENT EMPLOYEES FULLY UNDERSTAND THESE PROVISIONS.

IN SUMMATION, THE JOINT RESOLUTION, AS INTRODUCED, IS A VIGOROUS AND WELCOME REAFFIRMATION OF THE FREE ENTERPRISE SYSTEM THAT HAS MADE THIS COUNTRY STRONG. WE BELIEVE IT PROVIDES TIMELY SUPPORT FOR THIS ADMINISTRATION'S QUEST FOR A NEW, REVITALIZED APPROACH TO STRENGTHENING THIS COUNTRY'S ECONOMY. ECONOMY AND EFFICIENCY IN GOVERNMENT AND REWARD OF THE PRIVATE SECTOR FOR INITIATIVE AND PRODUCTIVITY ARE NECESSARY INGREDIENTS IN OUR FORMULA FOR ECONOMIC RENEWAL.

MR. CHAIRMAN, I HOPE THAT MY COMMENTS HAVE BEEN USEFUL IN EXPLAINING THE ADMINISTRATION'S POSITION ON THE JOINT RESOLUTION AND THE PROMISE IT HOLDS FOR MORE EFFECTIVE GOVERNMENT.

I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

THANK YOU.

Senator HAYAKAWA. Thank you very much.

We now turn to Mr. Clifford Gould, Director, Federal Personnel and Compensation Division, General Accounting Office.

STATEMENT OF CLIFFORD I. GOULD, DIRECTOR, FEDERAL PERSONNEL AND COMPENSATION DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C., ACCOMPANIED BY ALAN STAPLETON, EVALUATOR-IN-CHARGE, AND CHARLES BONANNO, GROUP DIRECTOR, GAO

Mr. GOULD. Thank you very much, Senator. It is a pleasure to be here again.

I would like to introduce Mr. Alan Stapleton. He is the evaluator in charge who has been doing the work in the consulting service area. To his left is Mr. Charles Bonanno, Group Director.

We are pleased to be here today to discuss our June 19, 1981, report on the kinds of work that Federal employees and Federal contractors are performing. That report showed that Federal agencies have used contractor personnel to do work that involves basic management functions. Although contractors may not be making final decisions, we are concerned about the extent to which the contractors are influencing agencies' control of Federal programs and policies.

At the same time that the Federal agencies are using contractor personnel for work that should be done in-house, they are using Government employees to provide commercial services that contractors could provide in many cases at lower cost.

We believe that if the agencies relied more on the private sector for commercial services, significant savings would accrue to the Government and agencies would be able to concentrate on their primary objective, the performance of Government functions.

Executive branch policy concerning agencies' use of Federal employees and contractors is prescribed in OMB Circular A-76. Basically, that circular provides that agencies should rely on the private sector for commercial goods and services and that all Government functions must be performed by Federal employees.

Recently, we have found that the Departments of Energy and Defense use contractors to substantially determine or influence national energy policies and to identify the requirements for national defense.

These Government functions are the responsibilities of the Secretaries of Energy and Defense, respectively, and should be performed by Federal employees to insure control over the direction of the agencies' programs and policies. Agencies often cite personnel ceilings as a primary reason for not having enough Federal employees to perform these essential functions.

Although Circular A-76 does not permit contracting for the performance of Government functions, it does permit agencies to obtain contractors' advice on such functions. However, it is sometimes difficult to tell where advice stops and performance begins.

Agency officials often contend that contractors do not perform Government functions and they only advise on the performance of such functions since a Federal official approves resultant policy directives or reports before they are issued. In our opinion, performance begins when a contractor's involvement is so extensive, as we found in Energy and Defense, that an agency's ability to develop options other than those proposed by the contractor is limited.

Our report recommended that the Director of OMB issue guidelines that will better define the differences between contractors' advice on Government functions and performance of such functions. OMB has agreed to do that.

To summarize the rest of my statement, Mr. Chairman, we have also found that there are about 400,000 Federal employees involved in commercial type activities in the Federal Government. We feel that many of these activities could be performed at substantially lower costs than they are being provided in-house with Federal employees.

We think it is interesting that those particular individual personnel slots, some 200,000 we estimate that might be made available, could then be used to provide the slots necessary for the Government to hire in-house capability to perform the management functions that we found contractors performing.

In our report, we also restated a recommendation that we thought that the Congress ought to establish a national policy as it related to contracting out. We think that your joint resolution does provide a forum for the dialog of establishing that national policy and we are pleased that you have introduced it.

We will be pleased to answer any questions.

[The prepared statement of Mr. Gould follow:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
Wednesday, June 24, 1981

STATEMENT OF

CLIFFORD I. GOULD
DIRECTOR
FEDERAL PERSONNEL AND COMPENSATION DIVISION

BEFORE THE

SUBCOMMITTEE ON THE ADVOCACY AND FUTURE
OF SMALL BUSINESS

ON

THE GOVERNMENT'S USE OF CIVIL
SERVANTS AND CONTRACTORS

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our June 19, 1981, report on the kinds of work that Federal employees and Federal contractors are performing. The report, entitled "Civil Servants And Contract Employees: Who Should Do What For The Federal Government?," showed that Federal agencies have used contractor personnel to do work that involves basic management functions. Although contractors may not be making final decisions, we are concerned about the extent to which contractors are influencing agencies' control of Federal programs and policies.

At the same time that Federal agencies are using contractor personnel for work that should be done in-house, they are using Government employees to provide commercial services that contractors could provide in many cases at a lower cost. We believe that if agencies relied more on the private sector for commercial services, significant savings would accrue to the Government and agencies would be able to concentrate on their primary objective--the performance of Government functions.

Executive branch policy concerning agencies' use of Federal employees and contractors is prescribed in the Office of Management and Budget (OMB) Circular A-76. Basically, the Circular provides that agencies should rely on the private sector for commercial goods and services and that all Government functions must be performed by Federal employees.

Recently, we have found that the Departments of Energy and Defense used contractors to

--substantially determine or influence national energy policies and

--identify the requirements for national defense.

These Government functions are the responsibility of the Secretaries of Energy and Defense, respectively, and should be performed by Federal employees to assure control over the direction of agency policies and programs. Agencies often cite personnel ceilings as a primary reason for not having enough Federal employees to perform these essential functions.

Although Circular A-76 does not permit contracting for the performance of Government functions, it does permit agencies to obtain contractors' advice on such functions. However, it is sometimes difficult to tell where advice stops and performance begins. Agency officials often contend that contractors do not perform Government functions--they only advise on the performance of such functions since a Federal official approves resultant policy directives or reports before they are issued. In our opinion, performance begins when the contractor's involvement is so extensive (as we found at Energy and Defense) that an agency's ability to develop options other than those proposed by the contractor is limited.

Our report recommended that the Director of OMB issue guidelines that will better define the differences between contractors' advice on Government functions and performance of such functions. OMB has agreed to do this.

Executive branch agencies, with few exceptions, have made little progress to implement Circular A-76's longstanding policy to rely on the private sector for goods and services. Although this policy has existed for more than 25 years, OMB information shows that as many as 400,000 Federal employees are currently operating more than 11,000 commercial or industrial activities at a cost of almost $19 billion annually. These employees represent almost one-fourth of the total executive branch civilian work force. Many of these Federal activities provide services--such as janitorial, guard, keypunching, and laundry services--that the private sector could often provide more economically. OMB has estimated that savings of $3.6 billion could be achieved during fiscal years 1982 to 1987 if all agencies fully implement Circular A-76.

It is important to recognize the foundation for the A-76 policy as stated in the Circular:

> "The Government's business is not to be in business. Where private sources are available, they should be looked to first to provide the commercial or industrial goods and services needed by the Government to act on the public's behalf."
>
> "In a democratic free enterprise economic system, the Government should not compete with its citizens. The private enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength."

GAO has consistently supported that policy while recognizing that improvements can be made in the procedures established to implement it.

Circular A-76 requires agencies to inventory their commercial or industrial activities and establish schedules for comparing costs to determine the most economical source of performance--contract or in-house. The Department of Defense has conducted more A-76 cost comparisons than any other Federal agency. About 60 percent of these comparisons show that it is more economical to convert the in-house activity to a contract.

If additional cost comparisons show that a large percentage of the commercial and industrial activities could be provided more economically by contract, agencies could reallocate many of these existing in-house commercial positions to work that must be performed by Federal employees--Government functions--without an increase in personnel ceilings and thus lessen contractors' involvement in basic management functions.

In a 1978 study, we found agencies' compliance with A-76 to be inconsistent and relatively ineffective. Over the years, different Administrations' support for the policy vacillated and agencies were reluctant to invest the resources necessary to fully implement the policy. To assure that agencies implement A-76 consistently, we recommended that the Congress legislate a national policy of reliance on the private sector for commercial goods and services.

Since that report was issued, agencies' progress to implement A-76 has been slow. On April 8, 1981, the Deputy Director of OMB, in a directive to executive branch agencies, concluded that overall implementation of A-76, with few exceptions, has been in a "vacuum."

OMB also stated that the new Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. OMB told four agencies to schedule over 95,000 positions for cost comparison studies by 1982 with more scheduled through 1985.

In view of the little progress agencies have made to effectively carry out this policy, we believe that the Congress should act on our earlier recommendation. Such legislation would preclude unilateral shifts in the policy by different Administrations by establishing a stable national policy that could not be changed significantly without congressional approval. The Deputy Director of OMB told us that OMB would not oppose such legislation if it clearly states that the Government's general policy is to rely on competitive private enterprise for needed goods and services.

To conclude, Mr. Chairman, we believe it is important for the Congress, as it strives to find every possible way to realize savings and control the growth of Government, to establish a national policy of reliance on this country's free enterprise system for the commercial goods and services it needs.

In this regard, we welcome your recent introduction of a joint resolution, along with Congressman Dreier, that would establish a national policy of reliance on the private sector for commercial goods and services. We believe this resolution has merit and should be favorably considered by the Congress. Such a policy would enhance agencies' ability to concentrate on the performance of Government functions. I would be happy to answer any questions.

Senator HAYAKAWA. Mr. Sowle, do you think that enactment of this resolution would necessitate reductions in Federal personnel ceilings?

Mr. SOWLE. Perhaps over the long run that would occur. I think in the short run, with the variations in missions of the agencies and the fact, as the GAO has pointed out that some Federal functions could perhaps be better handled, there will be a relocation of at least the manpower spaces if not the people. However, in the long run I think there should be a trend downward of the Government ceiling.

Senator HAYAKAWA. Mr. Gould, would you care to comment on the question?

Mr. GOULD. I think the answer from our perspective is speculative. We are not really sure how many management functions are being performed by contractors and how many additional spaces would be needed to provide those. It could well be less than the 200,000 that we feel could be saved in the commercial activities, but it could also be higher. We are really speculating as to whether there would be an increase or a decrease in the number of Federal employees.

Senator HAYAKAWA. Then, this is still to be determined?

Mr. GOULD. One of the problems we have had in determining those contracts for consulting services which get into governmental functions is just how much of it there is out there. There are so many varying definitions of what is a Government function. We need to get that addressed before we can make those kinds of determinations.

Senator HAYAKAWA. Speaking in my professional capacity as a semanticist, it seems to me that the definition of a Government function has to be left open. There is just no way of clearly drawing a line down the middle somewhere and saying that this is a non-Government function and this is a Government function. Would you not agree?

Mr. GOULD. I would respect your views as a semanticist. However, I think there can be perhaps a narrowing of that line so we eliminate some of the gray areas.

Senator HAYAKAWA. Mr. Sowle, in 1972, you directed the studies of the Commission on Federal Procurement. Recommendation 22 of that report addressed the need for legislation similar to my resolution. Have you seen any improvement in the implementation of A-76 since that time? If not, why not?

Mr. SOWLE. I think since that time it has been a vacillating sort of policy over the years. That is the reason the Commission recommended that we have some voice of the Congress as to what their intent was.

However, recommendation 22 that you refer to is back under active consideration in the development of our new procurement system, the management system for procurement, and of the statute that we are required to submit to the Congress by October of this year under our enabling statute, which is Public Law 96-83. This will be considered once again in much detail.

I think there have been some improvements in the last few months, maybe up to a year, in the application of A-76, yes, sir.

Senator HAYAKAWA. However, there has not been a concerted drive, has there?

Mr. SOWLE. Not until, I think, April of this year. Mr. Harper, the Deputy Director of OMB, went out with a letter to the agencies concerned, the ones that have the commercial-type activities. It was a very strong letter asking their management support to really do something about making cost comparisons for more effective Government.

Senator HAYAKAWA. Does the Office of Federal Procurement Policy or the OMB retain statistics on the implementation of A-76 on an agency-by-agency basis?

Mr. SOWLE. This has not been done up until recently. The letter I just mentioned that went out that Mr. Harper signed actually does require that the agencies submit data. We will have that in the future.

Senator HAYAKAWA. I would hope that information would be made available to this committee.

Mr. SOWLE. Yes, sir, we would be pleased to do that.

[Subsequent information was received and follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 8 1981

MEMORANDUM TO HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Edwin L. Harper, Deputy Director

SUBJECT: Implementation of OMB Circular A-76

One of the major goals within this Administration center on maximizing the efficient expenditure of funds. OMB Circular A-76 "Policies for Acquiring Commercial or Industrial Products and Services needed by the Government" provides you with one of the necessary tools to achieve this goal. This Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. Through proper and effective implementation of the Circular you will be able to achieve economies and efficiencies in operating commercial-industrial type activities by:

- Determining the least cost method of providing essential services (contract or in-house).

- Streamlining existing government organizations ensuring they are organized and staffed for the most efficient performance.

- Reducing long-range fiscal obligations through reductions in the Federal workforce when cost comparisons show a contract operation is more cost effective.

- Enhancing productivity through the development of measurable job standards.

The Circular provides that when private performance of commercial or industrial activities is feasible and no overriding factors require in-house performance, a rigorous comparison of contract costs versus in-house costs will be made, using the Circular's Cost Comparison Handbook, to determine whether the work will continue to be performed by in-house personnel or converted to a contract operation. The Circular contains several provisions that give appropriate consideration to affected Federal employees. Among the more significant ones are that:

- Existing in-house activities will not be converted to contract performance on the basis of economy unless it will result in a savings of at least 10 percent of the estimated Government personnel costs for the period of the comparative analysis; and

- Federal employees displaced as a result of the conversion to contract performance will be given the right of first refusal for employment openings in the contract operation.

In a recent review of agencies' overall implementation of the Circular, I noted that with a few exceptions, it has been in a vacuum principally because it lacked the requisite leadership and support from agency officials which is needed for effective implementation.

Under this Administration we have been charged, among other things, with the responsibility of ensuring economies and efficiencies within the Government. In fulfillment of these responsibilities, it is essential that you become vigorously involved and provide the overall leadership in your agency to fully implement the Circular by the close of fiscal year 1982. To assist you in accomplishing this, an OMB Bulletin is being issued which will provide the appropriate visibility needed to ensure it is effectively implemented.

Finally, there appears to be some confusion regarding the relationship between OMB Circular A-76 and other instructions that limit Federal civilian employment. Both the Circular and these instructions are complementary. The instructions preclude the use of contracting with firms and institutions outside the Government solely to circumvent personnel ceilings. Agencies that contract out for goods and services under the structured and deliberate process prescribed by OMB Circular A-76 are doing so because it is cost effective and reduces the growth in Government spending.

The Comptroller General, in a recent letter to us, reaffirmed not only the importance of the basic policy set forth in the Circular but also the significant savings in personnel positions which could occur if it were fully implemented in all agencies. In light of the trust and responsibilities placed in us by the American people, it is essential that we join together in forming a partnership to ensure OMB Circular A-76 is implemented in an effective and timely manner. Please be assured that my staff and I will work closely with you in this endeavor.

Edwin L. Harper
Deputy Director

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 8 1981

Honorable Caspar W. Weinberger
Secretary of Defense
Washington, DC 20301

Dear Mr. Secretary:

One of the major goals within this Administration centers on maximizing the efficient expenditure of funds. OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," provides you with one of the necessary tools to achieve this goal. This Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. Through proper and effective implementation of the Circular you will be able to achieve economies and efficiencies in operating commercial-industrial type activities by:

- Determining the least cost method of providing essential services (contract or in-house).
- Streamlining existing Government organizations ensuring they are organized and staffed for the most efficient performance.
- Reducing long-range fiscal obligations through reductions in the Federal workforce when cost comparisons show a contract operation is more cost effective.
- Enhancing productivity through the development of measurable job standards.

The Circular provides that when private performance of commercial or industrial activities is feasible and no overriding factors require in-house performance, a rigorous comparison of contract costs versus in-house costs will be made, using the Circular's Cost Comparison Handbook, to determine whether the work will continue to be performed by in-house personnel or converted to a contract operation. The Circular contains several provisions that give appropriate consideration to affected Federal employees. Among the more significant ones are that:

- Existing in-house activities will not be converted to contract performance on the basis of economy unless it will result in a savings of at least 10 percent of the estimated Government personnel costs for the period of the comparative analysis; and
- Federal employees displaced as a result of the conversion to contract performance will be given the right of first refusal for employment openings in the contract operation.

I am sure you are aware that the Department of Defense (DOD) has consistently been the leader in implementing OMB Circular A-76 and has accrued significant savings in the area of personnel resources as well as long-term expenditures. I look to your Office for continued leadership and the requisite support needed to complete implementation of the Circular, including completion of all associated cost studies by September 1985.

On the whole, we are pleased with your FY 1981-1982 plan to conduct cost comparison studies on 786 activities. We have, however, noted a trend over the past few years for the Services to withdraw earlier announced studies because of internal pressures. For example, 152 cost studies involving 3,846 personnel positions were deferred/cancelled in this same announcement. Additionally, we noted that certain functions such as operation of the commissaries and depot maintenance support have had very little exposure under the Circular. We believe that DOD, in FY's 1981-1982, by studying the four functions listed below which comprise approximately 52,000 personnel positions, could reallocate approximately 31,200 positions as a result of the cost comparisons. These functions are:

	Estimated Personnel
- Total Staffing of Commissaries	18,000
- Hospital Maintenance and Selected Total Hospital Operation	15,000
- Supply and Industrial Depot Maintenance Support Operations	15,000
- Audiovisual Including the Defense Audiovisual Activity Production Facility Located at Norton Air Force Base	4,000
Total	52,000

I strongly urge you and your staff to schedule these functions for cost comparison studies in fiscal years 1981-1982 to determine the most economical mode of operation. Accomplishment of these studies in that timeframe would move us closer to the realization of two of this Administration's goals. I look forward to your response regarding your plans to study the above listed functions.

Both the Circular and other instructions, limiting Federal civilian employment, are complementary. The instructions preclude the use of contracting with firms and institutions outside the Government solely to circumvent personnel ceilings. Agencies that contract out for goods and services under the structured and deliberate process prescribed by OMB Circular A-76 are doing so because it is cost effective and reduces the growth in Government spending.

In light of the trust and responsibilities placed in us by the American people, it is essential that we continue to work together in a partnership to ensure OMB Circular A-76 is implemented in an effective and timely manner. Please be assured that my staff and I will work closely with you in this endeavor.

Sincerely,

Edwin L. Harper
Deputy Director

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 8 1981

Mr. Ray Kline
Acting Administrator
of General Services
Washington, DC 20405

Dear Mr. Kline:

One of the major goals within this Administration centers on maximizing the efficient expenditure of funds. OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," provides you with one of the necessary tools to achieve this goal. This Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. Through proper and effective implementation of the Circular you will be able to achieve economies and efficiencies in operating commercial-industrial type activities by:

- Determining the least cost method of providing essential services (contract or in-house).

- Streamlining existing Government organizations ensuring they are organized and staffed for the most efficient performance.

- Reducing long-range fiscal obligations through reductions in the Federal workforce when cost comparisons show a contract operation is more cost effective.

- Enhancing productivity through the development of measurable job standards.

The Circular provides that when private performance of commercial or industrial activities is feasible and no overriding factors require in-house performance, a rigorous comparison of contract costs versus in-house costs will be made, using the Circular's Cost Comparison Handbook, to determine whether the work will continue to be performed by in-house personnel or converted to a contract operation. The Circular contains several provisions that give appropriate consideration to affected Federal employees. Among the more significant ones are that:

- Existing in-house activities will not be converted to contract performance on the basis of economy unless it will result in a savings of at least 10 percent of the estimated Government personnel costs for the period of the comparative analysis; and

- Federal employees displaced as a result of the conversion to contract performance will be given the right of first refusal for employment openings in the contract operation.

I recently reviewed your implementation of Circular A-76 and note that it has been in a vacuum for almost two years. I understand that one of the reasons the Circular has not been implemented within your Agency is due to the lack of a formal implementing order. Although such an order is not required by the Circular, our primary concern is that since the effective date of the Circular in all agencies was May 1, 1979, your agency has not reviewed a single in-house activity for possible conversion to contract performance. This gravely concerns us in view of the obvious savings that can be effected through reliance on the private sector.

In reviewing your inventory, I believe that the opportunity exists for you to conduct OMB Circular A-76 cost comparison studies on the four functions listed below which comprise over 13,000 personnel positions. These functions are:

Guard Services	3,000
Custodial	5,000
Building Maintenance	4,000
Motor Vehicle Operations and Maintenance	1,000
Total	13,000

Therefore, these functions shall be scheduled for cost comparison studies in FY 1981 and completed by September 1982. Accomplishment of these studies in that timeframe will move us closer to the realization of this Administration's goals. I look forward to your response regarding your specific plans to review the above listed functions.

One of the actions required to ensure uniform implementation of the Circular in the civilian agencies is the modification of the Federal Procurement Regulation (FPR). Your assistance is requested in publishing appropriate clauses and contract provisions thereby enacting uniform procurement procedures. The recently published draft Federal Acquisition Regulation A-76 coverage should be the basis of the procedures incorporated into the FPR. We would appreciate this being accomplished within 60 days.

Both the Circular and other instructions, limiting Federal civilian employment, are complementary. The instructions preclude the use of contracting with firms and institutions outside the Government solely to circumvent personnel ceilings. Agencies that contract out for goods and services under the structured and deliberate process prescribed by OMB Circular A-76 are doing so because it is cost effective and reduces the growth in Government spending.

In light of the trust and responsibilities placed in us by the American people, it is essential that we join together in forming a partnership to ensure OMB Circular A-76 is implemented in an effective and timely manner. Please be assured that my staff and I will work closely with you in this endeavor.

Sincerely,

Edwin L. Harper
Deputy Director

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 8 1981

Mr. Rufus H. Wilson
Acting Administrator
of Veterans Affairs
810 Vermont Avenue
Washington, DC 20420

Dear Mr. Wilson:

One of the major goals within this Administration centers on maximizing the efficient expenditure of funds. OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," provides you with one of the necessary tools to achieve this goal. This Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. Through proper and effective implementation of the Circular you will be able to achieve economies and efficiencies in operating commercial-industrial type activities by:

- Determining the least cost method of providing essential services (contract or in-house).
- Streamlining existing Government organizations ensuring they are organized and staffed for the most efficient performance.
- Reducing long-range fiscal obligations through reductions in the Federal workforce when cost comparisons show a contract operation is more cost effective.
- Enhancing productivity through the development of measurable job standards.

The Circular provides that when private performance of commercial or industrial activities is feasible and no overriding factors require in-house performance, a rigorous comparison of contract costs versus in-house costs will be made, using the Circular's Cost Comparison Handbook, to determine whether the work will continue to be performed by in-house personnel or converted to a contract operation. The Circular contains several provisions that give appropriate consideration to affected Federal employees. Among the more significant ones are that:

- Existing in-house activities will not be converted to contract performance on the basis of economy unless it will result in a savings of at least 10 percent of the estimated Government personnel costs for the period of the comparative analysis; and
- Federal employees displaced as a result of the conversion to contract performance will be given the right of first refusal for employment openings in the contract operation.

I recently reviewed your Agency's overall implementation of the Circular and am, on the whole, pleased with your recent progress. I look to your Office for continued leadership and the requisite support needed to fully implement the Circular, including completion of all associated cost studies, by September 1983. I believe the additional twelve-month extension in implementing the Circular will allow you to proceed in an effective and orderly manner.

In reviewing your program, I believe that the opportunity exists for you to conduct A-76 cost comparison studies on the three functions listed below, which comprise over 22,800 personnel positions. These functions are:

Function	Approximate Personnel Spaces
Hospital Food Preparation	10,900
Hospital Custodial	7,900
Hospital Plant Maintenance	4,000
Total	22,800

I strongly urge you and your staff to schedule these functions for cost comparison studies in FY 1981 and complete them by September 1982. Accomplishment of these studies in that timeframe will move us closer to realization of this Administration's goals. I look forward to your response regarding your plans to study the above listed functions.

Both the Circular and other instructions, limiting Federal civilian employment, are complementary. The instructions preclude the use of contracting with firms and institutions outside the Government solely to circumvent personnel ceilings. Agencies that contract out for goods and services under the structured and deliberate process prescribed by OMB Circular A-76 are doing so because it is cost effective and reduces the growth in Government spending.

In light of the trust and responsibilities placed in us by the American people, it is essential that we continue to work together in a partnership to ensure OMB Circular A-76 is implemented in an effective and timely manner. Please be assured that my staff and I will work closely with you in this endeavor.

Sincerely,

Edwin L. Harper
Deputy Director

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 8 1981

Honorable Richard S. Schweiker
Secretary of Health
and Human Services
200 Independence Avenue, SW
Washington, DC 20201

Dear Mr. Secretary:

One of the major goals within this Administration centers on maximizing the efficient expenditure of funds. OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," provides you with one of the necessary tools to achieve this goal. This Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. Through proper and effective implementation of the Circular you will be able to achieve economies and efficiencies in operating commercial-industrial type activities by:

- Determining the least cost method of providing essential services (contract or in-house).
- Streamlining existing Government organizations ensuring they are organized and staffed for the most efficient performance.
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- Enhancing productivity through the development of measurable job standards.

The Circular provides that when private performance of commercial or industrial activities is feasible and no overriding factors require in-house performance, a rigorous comparison of contract costs versus in-house costs will be made, using the Circular's Cost Comparison Handbook, to determine whether the work will continue to be performed by in-house personnel or converted to a contract operation. The Circular contains several provisions that give appropriate consideration to affected Federal employees. Among the more significant ones are that:

- Existing in-house activities will not be converted to contract performance on the basis of economy unless it will result in a savings of at least 10 percent of the estimated Government personnel costs for the period of the comparative analysis; and
- Federal employees displaced as a result of the conversion to contract performance will be given the right of first refusal for employment openings in the contract operation.

I recently reviewed your Department's overall implementation of the Circular and am, on the whole, pleased with your recent progress. I look to your Office for continued leadership and the requisite support needed to fully implement the Circular, including completion of all associated cost studies, by March 1982.

In reviewing your program, I believe that the opportunity exists for you to conduct A-76 cost comparison studies now on the major functions listed below, which comprise over 8,000 personnel positions. These functions are:

Function	Approximate Personnel Spaces
ADP, including SSA annual wage reporting activities	5,000
Support type services including mail service, audiovisual activities, plant and facilities maintenance, and custodial services.	3,000
Total	8,000

I strongly urge you and your staff to schedule these functions for cost comparison studies in FY 1981 and complete them by the second quarter of FY 82. Accomplishment of these studies in that timeframe will move us closer to realization of this Administration's goals. I look forward to your response regarding your plans to study the above listed functions.

Both the Circular and other instructions, limiting Federal civilian employment, are complementary. The instructions preclude the use of contracting with firms and institutions outside the Government solely to circumvent personnel ceilings. Agencies that contract out for goods and services under the structured and deliberate process prescribed by OMB Circular A-76 are doing so because it is cost effective and reduces the growth in Government spending.

In light of the trust and responsibilities placed in us by the American people, it is essential that we continue to work together in a partnership to ensure OMB Circular A-76 is implemented in an effective and timely manner. Please be assured that my staff and I will work closely with you in this endeavor.

Sincerely,

Edwin L. Harper
Deputy Director

Senator HAYAKAWA. Mr. Gould, in your testimony, you stated that 400,000 Federal employees are operating more than 11,000 commercial or industrial activities at a cost of almost $19 billion annually. How did the GAO arrive at the dollar figure and how did it arrive at the figure of the number of Federal employees involved and so on? Those are pretty staggering statistics.

Mr. GOULD. The executive branch agencies reported these costs to OMB as of February 1981. I might add that these costs do not include commercial and industrial activities with annual operating costs of less than $100,000.

The estimate of the $19 billion and the number of employees came from OMB. We did not verify those estimates.

Senator HAYAKAWA. I invite any one of you to contribute to the answers to these questions including Mr. Stapleton, Mr. Bonanno, and Ms. Druyun.

Mr. SOWLE. I was just going to comment again, Mr. Chairman, that the $20 billion and the savings that we estimated were based primarily on the DOD and extrapolation from that.

Senator HAYAKAWA. That is a huge agency to start with.

In your opinion, Mr. Gould, what dollar amount representing what percent of that $19 billion could be saved if agencies fully implemented A-76?

Mr. GOULD. Again, I probably ought to let Mr. Sowle answer that because the estimate did come from OMB. They estimated $3.6 billion in savings during fiscal years 1982 through 1987 if all the agencies were to fully implement A-76. These projections of savings assume that 60 percent of the cost comparisons will continue to show that it is more economical to convert in-house activities to contract and that the contract will save an average of 20 percent over in-house cost. Again, that is based on estimates on DOD experience.

Senator HAYAKAWA. The General Accounting Office recommends in its report that the Congress enact legislation requiring Federal agencies to fully disclose information regarding consulting service contractors' assistance in preparing reports. Is that correct?

Mr. GOULD. That is correct.

Senator HAYAKAWA. Why does GAO believe this is necessary?

Mr. GOULD. Because the contractors in doing consulting services actually get involved in governmental functions. We think that when those reports come up to the Congress the Congress ought to be fully informed as to what the basis for those studies are so that they do not assume they are performed totally in-house with Federal employees and so they have the benefit of knowing any biases that may have been generated as a result of contractors' other concerns.

Senator HAYAKAWA. Mr. Sowle, do you want to add anything to that?

Mr. SOWLE. I guess I would like to respond in this way: We do not feel that identifying contractors to the Congress is really a necessary thing. This information is available at any time if the Congress has any questions, plus the fact that when a report is submitted to the Congress, the management of the agency or the manager within the executive branch that submits that is responsible for whatever he submits.

On top of that, if you follow this to the letter of the recommendation, and if, for example, you have a contractor with several subcontractors or some consultants working with him, it is very difficult to try and identify every little participant in the preparation of material for the executive branch or for the manager.

I think this could be much cleaner. If they thought there was some bias in some area, they could ask specifically who participated in preparing the report. Even if you got the prime contractor or the prime consultant agency who had helped with a particular problem, you could not be assured that his biases, if there were any, were shown because of other people who might have worked on the report.

I think this could be a very burdensome and unnecessary type requirement to place on the management of the agencies.

Senator HAYAKAWA. Thank you, Mr. Sowle.

Mr. Stapleton, Mr. Bonanno, Ms. Drryun, I have not heard anything from the three of you yet. Do you have anything you wish to add? Do you feel a speech coming on?

Mr. BONANNO. With respect to the last question, I would just like to comment that a review we made for Senator Pryor approximately a year ago found that many congressionally mandated reports did not disclose that contractors were involved in their preparation. Therefore, there really would not be any basis for Members of Congress or others to question or ask for information relative to who the contractors may have been. That is one of the primary reasons why we think the legislative recommendation we made is important.

Senator HAYAKAWA. In the case of further questions that remain unanswered, we may write to you and send you questions. I would invite your written comments in response.

[Subsequent information was received and follows:]

LOWELL P. WEICKER, JR., CONN., CHAIRMAN
BOB PACKWOOD, OREG.
ORRIN G. HATCH, UTAH
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RUDY BOSCHWITZ, MINN.
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R. MICHAEL HAYNES, CHIEF COUNSEL
ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 30, 1981

Honorable Donald Sowle
Administrator
Office of Federal Procurement Policy
Office of Management and Budget
New Executive Office Building
Washington, D. C. 20503

Dear Mr. Sowle:

I personally would like to thank you for testifying before the Subcommittee on Advocacy and the Future of Small Business on Wednesday, June 24, 1981. I believe that our initial investigation into the extent of government competition with small business was both enlightening and thought-provoking. I am looking forward to further, in-depth hearings on this important issue.

As I mentioned during the hearing, I did not have the opportunity to pose all of the questions I had hoped to ask. Accordingly, I have enclosed additional questions and would very much appreciate your written response for the official hearing record. Any additional comments you have for the record are welcome also.

If you have any questions about these materials, please do not hesitate to call Kimberly Elliott with the Small Business Committee at (202) 224-3840 or Grace Hussie on my personal staff at (202) 224-3841.

Again, thank you for your participation in what I believe was a very productive hearing.

Sincerely,

S. I. HAYAKAWA
Chairman
Subcommittee on Advocacy and
the Future of Small Business

Enclosure

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT POLICY

AUG 18 1981

Honorable S.I. Hayakawa
Chairman
Subcommittee on Advocacy and the
Future of Small Business
U.S. Senate
Washington, D. C. 20510

Dear Senator Hayakawa:

As requested in your June 30, 1981 letter, I have enclosed responses to the additional questions to me resulting from the June 24, 1981 hearings.

Please do not hesitate to call if you have further questions.

Sincerely,

Donald E. Sowle
Administrator

Enclosure

Questions from Senator Hayakawa

1. Q. Does OMB Circular A-76 need to be revised in some areas?

A. No. At this time, we see no need to revise the basic policy contained in OMB Circular No. A-76. Further, in an April 8, 1981 memorandum to agency heads, OMB Deputy Director Harper directed most agency heads to fully implement the Circular -- as it is now written --by the close of fiscal year 1982. Two extensions of this date were made for the Veterans Administration (end of fiscal year 1983) and the Department of Defense (end of fiscal year 1985) because of the size of their programs.

2. Q. How does OMB or OFPP plan to clarify what is a "governmental function" as opposed to what is permissible consultant advice?

A. OMB plans to issue a desk pamphlet on consulting services in the near future. In the pamphlet will be a section discussing the relationship of governmental functions to consulting services.

3. Q. Do you believe that my resolution should become part of the proposal to revise the Federal Procurement System?

A. Yes. We fully support the joint resolution with its general policy statements.

4. Q. Given your vast experience with Federal procurement laws, do you have any further comments for the Subcommittee?

A. The proposal to change current Federal procurement practices can change -- for the better -- how the Government acquires the goods and services it needs. The hallmarks of the new approach, are: (1) a simplified system -- both timely and responsive; (2) increased latitude for personal initiative and judgment with emphasis on professionalism, responsibility, and accountability; (3) more meaningful competition with latitude for innovative low cost solutions; and (4) uniform policy and improved management with needed operational flexibility. While the proposed system may include some of what exists today, the new design will overcome existing biases and start anew. The comprehensive reform effort mandated by the Congress requires an uninhibited approach to, and creative solution of, any burdens and inefficiencies associated with the Federal procurement process as it now exists.

LOWELL P. WEICKER, JR., CONN., CHAIRMAN
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ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 30, 1981

Mr. Clifford I. Gould, Director
Federal Personnel & Compensation Division
General Accounting Office
441 G. Street, N.W.
Washington, D. C. 20548

Dear Mr. Gould:

I personally would like to thank you for testifying before the Subcommittee on Advocacy and the Future of Small Business on Wednesday, June 24, 1981. I believe that our initial investigation into the extent of government competition with small business was both enlightening and thought-provoking. I am looking forward to further, in-depth hearings on this important issue.

As I mentioned during the hearing, I did not have the opportunity to pose all of the questions I had hoped to ask. Accordingly, I have enclosed additional questions and would very much appreciate your written response for the official hearing record. Any additional comments you have for the record are welcome also.

If you have any questions about these materials, please do not hesitate to call Kimberly Elliott with the Small Business Committee at (202) 224-3840 or Grace ~~Hussie on~~ my personal staff at (202) 224-3841.

Again, thank you for your participation in what I believe was a very productive hearing.

Sincerely,

S. I. HAYAKAWA
Chairman
Subcommittee on Advocacy and
the Future of Small Business

Enclosure

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FEDERAL PERSONNEL AND
COMPENSATION DIVISION

JUL 31 1981

PC-4536

The Honorable S. I. Hayakawa
Chairman, Subcommittee on Advocacy
and the Future of Small Business
Select Committee on Small Business
United States Senate

Dear Mr. Chairman:

In your letter of June 30, 1981, you requested our written responses to several questions to be included in the Subcommittee's June 24, 1981, official hearing record on the Government's competition with small business. Our responses for the official hearing record are enclosed.

I want to thank you for inviting me to participate in the Subcommittee's hearing and for your interest in our recent report on the need for a national policy of reliance on the private sector for commercial services. Your introduction of a joint resolution establishing such a policy is an important step forward.

Sincerely yours,

Clifford I. Gould

Clifford I. Gould
Director

Enclosure

1. Could you elaborate on how full implementation of A-76 would allow the Federal work force to shift its concentration from commercial or industrial activities to performance of truly governmental functions? Would this shift result in a reduction of Federal personnel ceilings?

Answer

Through implementation of A-76, agencies can reallocate commercial-type positions to work that must be performed by Federal employees--Government functions. Circular A-76 states that Government functions must be performed in-house. Accordingly, agencies should give this work priority when reallocating commercial-type positions freed-up through implementation of A-76.

There are too many variables involved to predict whether implementation of A-76 would result in a reduction of personnel ceilings. For example, if the "government function" workload increases dramatically in the next several years, all freed-up commercial-type positions may need to be reallocated to fill this increasing demand. If the Government function workload does not increase, it may be possible to reduce personnel ceilings. Another variable is the rate at which agencies implement A-76, thus influencing the number of commercial-type positions that can be reallocated.

2. Does the GAO have any specific recommendations on how to clarify the difference between a contractor's "advice" and his performance of a "government function?"

Answer

Agencies can differentiate between contractor's advice and performance of a Government function when writing the statement of work in the contract. For example, an agency will often write the statement of work to require the contractor to develop, identify, or establish certain agency policies and priorities.

In our opinion, the establishment of agency policies and priorities is a management function that should be performed by accountable Federal officials. When contractors' involvement in basic management functions is so extensive that an agency's ability to develop options other than those proposed by the contractor is limited, "advice" can become "performance." One way to preclude advice from becoming performance is for the agency to include in the statement of work those policies or issues under consideration and then ask the contractor to delineate the relative advantages and disadvantages of each alternative.

3. Is the cost comparison process outlined in A-76 functioning, or does it need revision? If so, in what areas?

Answer

In an April 22, 1981, report (PLRD-81-19), we noted two areas in which the A-76 guidelines appear to need revision to enhance comparability and equity in making cost comparisons. The rules concerning the treatment of unoccupied in-house positions and the adjustment of in-house personnel costs for inflation tend to favor contracting out. We recommended that OMB assess the need to modify the guidelines.

4. In its report, GAO recommends that the Congress enact legislation requiring Federal agencies to fully disclose information regarding consulting service contractors' assistance in preparing reports? Why does GAO believe this is necessary?

Answer

We believe that when the Congress mandates an agency to prepare a report on an important issue, the members of the Congress who are reading the final report should know who prepared it--accountable Federal officials or contractors. As we discuss in our report, we have found agencies often use contractors extensively in preparing the reports but do not recognize contractors' assistance in the final report. Often times these reports establish agency policies and priorities and thus become a "Government function." By stating in the final report what role contractors played in its preparation, agencies can enable the Congress to better determine if the contractors' "advice" in preparing the report has become performance of a Government function. Since congressionally-mandated studies can influence the congressional oversight process and future direction of Government programs, it is important that the Congress be fully apprised of contractors' assistance.

Senator HAYAKAWA. If there are no further statements to be made, I would like to bring today's hearings to a close with a few remarks. I feel a speech coming on myself.

I would like to tell you of my own personnal interest in small business and its success. This is part of my own biography.

In the first eight grades of grade school I went to—I skipped one grade so I got it all over in 7 years—I went to a different school every September. It was often in a different city in western Canada.

The reason was that my father started one small business after another, which went under, and we moved on somewhere else to another opportunity. I remember little grocery stores we ran in places like Cranbrook, British Columbia; Raymond, Alberta; Calgary, Alberta; and so on. I remember that he acquired a poolhall at one stage in payment of some debts. However, he had to keep moving.

Then came the outbreak of World War I and the sudden cessation of imports of all sorts of small items like hardware, toys, ceramics, and so on from Czechoslovakia and Germany. Therefore, there was a great opportunity for Japanese imports. He got into the import business from Japan.

Those were the days when the Japanese merchandise was really junk merchandise, but it did meet a need. My first business experiences dealt with traveling around western Canada as a salesman with samples from my father's enterprises. However, he was not very successful. If he had succeeded in becoming a big businessman, I am sure I would have had an easier time of getting through college, or at least a better time.

By the time the Second World War came along, father had become quite successful. He had moved his headquarters to Osaka. He was still in the import/export business. When I visited him after I got my Ph. D. at the University of Wisconsin, he had a big office full of clerks and letterwriters because he had customers, he told me, in Europe, South America, Africa, and all around the world for all sorts of small items that were exported from Japan such as cigarette lighters and souvenir handkerchiefs to be sold to sailors at, for example, the then British port of Aden. They sold millions of souvenirs there and father supplied a lot of them. He supplied electric light bulbs, Christmas tree ornaments, and Easter chicks by the millions at Eastertime. He was doing fine.

I recall his great pleasure when he told me then that every clerk in that big office had to be able to read and answer letters in at least two languages or else was not of any use to him. I asked him, "Do you ever receive letters in a language nobody in your office can understand?" He said, "If it is an order, we can understand it. If it is a complaint, we cannot."

The war wiped him out completely. The American bombers over Nagasaki, Osaka, et cetera, wiped out everything he had. Then he had to go to work for somebody else. He hated that. He just could not stand that.

After working for somebody else after he had been wiped out by the war, in 1950, 5 years after the war was over, he decided to strike out for himself all over again. He started a new company.

Since I was a Ph. D. in English, he wrote me and asked me, "What do you think I should name my company?"

Taking a hint from one of his own mottos, world unity through world trade—he was a great believer in free trade—I suggested he call his new company United Trading Co. At the age of 66, he incorporated again and started out anew.

United Trading Co. never amounted to much, but it did not go under. It survived. Some years after his retirement and his death at the age of 92, the company still survives. I hope it prospers, but I do not hear anything about it anymore.

This complete dedication to free enterprise and individual enterprise was something that he believed in so very profoundly. And I have been on the public payroll at State universities and the Federal Government ever since. It seems a kind of irony. Nevertheless, I do recall these things with some pleasure.

In 1955, I moved to California. In that year, there was only one McDonalds hamburger place. I think it was in Chicago. Now there are several thousand McDonalds around the world.

I remember in about 1975 or 1976 I was a passenger on an airplane beside a man who had a McDonalds franchise. He told me about what a great outfit McDonalds was. He said, "We have put more kids through school because we provide employment." He was proud of the statistics he had at his fingertips on the number of young men and women he had enabled to get through high school and college because he had a small business.

Later, still talking about the great company he was associated with, he said, "Do you realize that by the end of 1975, we will have 100 McDonalds outlets in Japan?"

However, now there are several thousand of those in Japan. After having become a Senator, I visited the city of Kofu where my father went to high school and where my mother was born and brought up. Kofu is a small city in Yamanashi prefecture. There, right in the middle of town, was a McDonalds hamburger place with the great golden arches and hundreds of bicycles parked outside and hundreds of kids inside having hamburgers. As I saw those golden arches, I thought, "God, am I proud to be an American."

I continue to be interested in small business although my own entire life has been in academics. I want to thank each of you for the testimony that was presented which contributed much to my education. It has provided the Subcommittee on Advocacy and the Future of Small Business with a real overview of the competitive situation and real ammunition to use in future activities of this subcommittee.

I will keep the hearing record open for a week so that we can include any additional materials you may wish to submit. I would also welcome any statements that a small business owner or trade association not represented here today may wish to submit for the record.

I also want to announce that I am going to have field hearings in California and elsewhere on the subject.

Again, I wish to thank all of you for your participation.

The Subcommittee on Advocacy and the Future of Small Business now stands adjourned.

[The subcommittee adjourned at 12:20 p.m.]

GOVERNMENT COMPETITION WITH SMALL BUSINESS

THURSDAY, AUGUST 27, 1981

U.S. SENATE, SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,

Los Angeles, Calif.

The subcommittee met at 10 a.m., at 300 North Los Angeles Street, Los Angeles, Calif., Hon. S. I. Hayakawa, chairman, presiding.

Present: Senator Hayakawa.

Also present: Kimberly A. Elliott, professional staff member.

STATEMENT OF HON. S. I. HAYAKAWA, A U.S. SENATOR FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS

Senator HAYAKAWA. Good morning.

The Subcommittee on Advocacy and the Future of Small Business of the Senate Small Business Committee is investigating a complex and controversial issue: To what extent does the Federal Government compete with private business, especially small business?

This is our second hearing on this important subject, and I am very pleased to provide an opportunity for our California small business people to tell us how Government competition affects their companies.

While this country was founded on the principle that private enterprise, not the Federal Government, should conduct business activities, there has been a steadily increasing trend away from this position. Since the business of Government is not to be in business, I ask myself why Federal employees are currently operating over 11,000 commercial or industrial activities at a taxpayer cost of $19 billion each year? And, I wonder what has become of our longstanding national policy of reliance on the free enterprise system to provide the commercial goods and services used by the Federal Government?

Small business owners around the country are asking themselves similar questions. But to these small business men and women the issue of Government competition represents more than a policy debate on the proper role of Government in a free enterprise system. For them, Government competition is often a matter of economic survival.

Last year, the Small Business Administration's Office of Advocacy thoroughly studied the extent of Government competition with small business. A report published by that office found that small firms could gain more than $2 billion annually if the Federal Government produced less of its own goods and services and bought more from the private sector.

I would like to point out that the problems related to Government competition do not exist only at the Federal level—they extend to State, city, and county governments as well. I recently received a letter from a California businessman who manufactures gopher bait which is used to control pocket gophers. He summarized his problems with Government competition by saying:

> I wish to inform you that my biggest competitor is the Government. The California Department of Agriculture and the U.S. Office of Fish and Wildlife are making sizable profits selling gopher baits while the private manufacturer is operating at a greater loss in revenues through higher costs of materials, equipment, supplies, and fees paid to Government agencies.

At this point I would like to submit the remainder of his very interesting letter for the hearing record.

Because of my grave concern over incidents like these at all levels of government, I have introduced Senate Joint Resolution 93 that would reaffirm a longstanding policy of the Government to rely on the private sector for the supply of its needed goods and services whenever competitive prices are available. If passed, the resolution would provide a statutory base for a policy that has heretofore existed only in an executive policy directive. Our first witness, Congressman David Dreier, has introduced an identical resolution in the House of Representatives.

The Reagan administration completely supports the resolution and testified to that effect at our initial hearing. In fact, a recent U.S. News and World Report article stated that:

> Ronald Reagan, aiming to promote free enterprise and save taxpayers money is launching the most determined drive in years to get Uncle Sam out of competition with private business. If the President has his way, the United States soon will be relying less on Federal workers and more on private contractors for a vast assortment of goods and services—from trash collecting to computer keypunching.

That is the end of the quotation from the President.

We want to help the President.

So, let us begin. I would like to welcome all of our small business witnesses who have taken time from their busy schedules to be here today. I also welcome the representatives of national organizations that have come here to share their opinions on Government competition.

Just before I call our first witness, I would like to submit an additional document for this record. I have received a letter from my colleague, Senator Arlen Specter of Pennsylvania, who has cosponsored Senate Joint Resolution 93. He writes me in support of the measure and his intent to introduce additional legislation on this issue.

[The material follows:]

ARLEN SPECTER
PENNSYLVANIA

COMMITTEES
JUDICIARY
APPROPRIATIONS
VETERANS AFFAIRS

United States Senate
WASHINGTON, D.C. 20510

August 20, 1981

The Honorable S. I. Hayakawa
United States Senate
Washington, D.C. 20510

Dear Sam:

I understand you have a further hearing scheduled for August 27th on S. J. Res. 93, a Joint Resolution to clarify that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

As you know, I am a cosponsor of this bill and am much interested in the idea of stimulating the use of private sector commercial and industrial resources to meet government procurement needs whenever possible. I agree with the statement of the Administrator of the Office of Federal Procurement when he testified before your Committee on June 24th on behalf of OMB that "we endorse the statement that the private enterprise system consisting of businesses, both small and large, is the primary source of national economic strength. This country has traditionally looked to the private sector to pave economic paths because of its willingness to take risks, seek costs, and create and use new technology. In this respect, business adds to the Federal, state, and local tax revenues instead of using the revenues -- which is the case when the Government provides its own needed goods and services.

Thus, it is important for the economy and on behalf of the taxpayer that Government encourage the private commercial and industrial sector rather than compete with it.

To supplement S. J. Res. 93, I plan to introduce after the recess the Private Sector Federal Procurement Act of 1981. This proposed legislation is based in part on the material developed in your previous hearing and in the Report Government Competition: A Threat to Small Business, a produce of the SBA Advisory Task Force Group on Government Competition with Small Business.

Again, I commend you for your hearing and want to assure you of my interest and support for your efforts.

Sincerely,

Arlen Specter

Senator **Hayakawa**. I would now like to call on our witness, the Honorable David Dreier, who represents California's 35th District.

STATEMENT OF HON. DAVID DREIER, A U.S. REPRESENTATIVE FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS OF THE HOUSE COMMITTEE ON SMALL BUSINESS

Representative **Dreier**. Thank you very much, Senator. I would like to say at the outset that I appreciate the opportunity to be with you here this morning at this Senate hearing, and I also would like to say that I have enjoyed working with you on this project of introducing it in both Houses. You certainly have had more experience, as I am a veteran of 6 months in Washington, and this has been one of my first major pieces of legislation. I enjoyed very much being able to work with you on it.

The heart of American industry lies in the small business sector and small business accounts for 43 percent of the Nation's gross national product and provide virtually all new private sector employment. Even though small businesses are responsible for more than half of all major innovations in this country, they are failing at an ever-increasing rate. Small business is the most talked about, but least acted upon, sector of our economy.

I think there are several reasons why America is now experiencing an alarming number of closures and business bankruptcies of small enterprises. It is therefore essential that policies be implemented to create an environment in which industrial initiative and ingenuity can prosper.

In recent years we have observed that Federal Government increasingly assumed functions that should be left to the private sector of the economy, although longstanding Federal procurement policy as set forth in circular A-76 has been that the Government shall rely on the private sector for needed goods and services, this policy has never been consistently or aggressively implemented or supported by successive administrations. It is for this reason I introduced House Joint Resolution 294 to reaffirm the Federal Goverment's commitment to rely on, if economically possible and feasible, the goods and services of private enterprises.

In spite of the fact that the policy of reliance on private enterprise has officially existed since 1955, Government Accounting Office figures indicate that Federal employees are currently performing, as you stated, some 11,000 commercial or industrial activities. Numerous examples of Government involvement in commercial and industrial activities has been outlined in a recently released report by the General Accounting Office. These activities include, for example, keypunching and data entry services, film and videotape production, and art and graphic services. But these are only a small portion of the more than 11,000 activities currently engaged in by the Government, which annually costs taxpayers more than $19 billion.

This past week I had the opportunity to meet with nine local Chamber of Commerce representatives in my congressional district. These representatives voiced their strong concerns over the ongoing relationship between small business and the Federal Government. Chamber officials complained that the Federal Government has awarded few contracts to small business. The message was made quite clear, when dealing with the Federal Government, small businesses are cut out with most contracts going to Government entities. Since introducing my resolution, I have received many calls and letters from small businesses throughout the country who have outlined specific examples of how their businesses have been crippled by the encroachment of Government competition.

Government's growing intrusion into the marketplace has already taken its toll on American small business enterprises. It is essential that the Government stop competing against private firms which could produce goods and products or private services at a lower cost than the Government currently can, while struggling with the intricacies of the marketplace and legislation, so the last thing they need is competition from the Government financed by tax money. When Government competes without the simple economic restraints imposed on the private sector, real competition ceases to exist, and the U.S. taxpayer must carry the burden. It is inconsistent to find private industry contributing exorbitant tax revenues and then competing for jobs with its own Government.

Federal agencies have been relatively free to create huge, extensive facilities, staffed by thousands of Government employees, whose wages and benefit packages generally far exceed those of their counterparts in industry. Congressional action can preclude unilateral shifts in the interpretation of circular A-76 and will establish a uniform and consistent national procurement policy. Through a greater reliance on the private sector the 1980 Small Business Administration report estimates taxpayers can save nearly $3 billion annually. Small business would benefit from House Joint Resolution 294, as $2 billion would flow to this vital segment of our economy. My resolution is based on the General Accounting Office study, "Civil Service and Contract Employees, Who Should Do What for the Federal Government?"

The resolution is a reaffirmation of the policy that the Government rely on competitive private enterprise to supply the products and services it needs whenever possible and available. This action would provide the necessary incentives for Federal agencies to implement the policy with the assurance that it could not be changed again without congressional approval.

I am pleased to say that this resolution is strongly endorsed also on the House side by the OMB and the staff. Donald Sowle, Administrator for Federal Procurement Policy commended the resolution for its "timely support for this administration's quest for a new revitalized approach to strengthen the country's economy."

I believe the enactment of this resolution will help stimulate the small business community and at the same time allow the Federal Government to benefit by depending on the private sector to provide nongovernmental services and policies. It is imperative that Congress provide relief for America's small business sector. We must work for enactment of legislation to protect small business, not destroy the American free enterprise system.

I compliment you, Senator Hayakawa, for conducting this hearing in order to examine specific problems which have threatened the very existence of small business I again appreciate being able to participate with you here today.

Senator HAYAKAWA. Thank you, Congressman Dreier, we are very grateful for your very thorough and eloquent statement.

Would you like to join me up here?

Representative DREIER. Thank you very much.

Senator HAYAKAWA. Out first panel will be Mr. Gene Zerlaut, DSET Labs, Inc., Phoenix, Ariz.; Dr. Charles Evans, president, Charles Evans & Associaties of San Mateo; and Mr. Floyd Loupot, president, American Hearing Aid Center, Pasadena.

Would you gentlemen take your places up here. Are you prepared to testify in any particular order?

You wish to start with Mr. Zerlaut?

STATEMENT OF GENE A. ZERLAUT, PRESIDENT, DSET LABORATORIES, INC., PHOENIX, ARIZ.

Mr. ZERLAUT. Thank you.

Mr. Chairman, Congressman Dreier, members of the committee, committee staff, ladies and gentlemen. My name is Gene Zerlaut. I am president of DSET Laboratories, Inc., a high technology, private sector small business. Our company is considered to be the most sophisticated outdoor materials weathering and solar device testing laboratory in the world.

The work in process is represented by some 600 industrial and governmental clients located in 23 countries throughout the world. We constructed custom facilities for materials testing and thermal testing of all types of solar devices since the summer of 1974. From the outset DSET has been plagued by public-supported and tax-favored competition that has forced us to artificially suppress our test fees to a degree that has never allowed a reasonable return on investment. Although our prestige has steadily increased and our business has grown, the constant competition from the university sector, the consequences of a number of Federal activities that have had an adverse effect upon my company, competition from the national laboratories, and the emergence of the Solar Energy Research Center monitored by the State of Florida, a State-supported, university operated official test laboratory, have all caused us to believe that at this point we may never amortize our solar collector test facilities. In my written statement I have detailed a number of instances where Federal agencies have constituted either direct or indirect competition and have served to seriously affect my company.

At this time I would like to share with you several activities that have a most critical effect on the health of DSET in the next couple of years. In fact, largely as a result of actions of the Department of Energy, my company has become one of the Small Business Administration's largest federally guaranteed solar loan recipients.

In 1975 the Florida Legislature created the Florida Solar Energy Center to certify and test solar collectors. Since October 1976 when FSEC commenced commercially testing solar collectors, our Florida-based clients have dwindled from more than 25 to 2 or 3. If the Florida Legislature is the mother of FSEC, the Department of Energy might be said to be its midwife—through excessive grants and contracts that help to sustain them in the dual role of product certifier and test laboratory.

Turning to the national laboratories, DSET has since 1974 watched the gradual buildup within the national laboratory structure of testing capabilities that have existed at my company and other member organizations of the American Council of Independent Laboratories. Between DSET and several similar outdoor environment test laboratories, more than 15 private-sector, small business-owned exposure test sites have been operated for up to 30 years. Yet, to the best of our knowledge, not a single test demonstration solar array has been placed at these commercial sites, and most of them have been set up by the National Laboratories from scratch, including several at university and university-operated facilities.

Several of the National Laboratories have operated test facilities for industry where the capabilities exist in the private sector and where the necessary Government-funded testing for industry could have been performed under contract in the private sector. One case is the Jet Propulsion Laboratory's testing for the National Photovoltaic program. DSET has enjoyed a small program from JPL for the past 3 years dealing with environmental stress testing of photovoltaic modules. Citing a cutback in funding and a change in test philosophy, JPL has discontinued our test contract only a few short months after we jointly presented a paper in Europe in which JPL cited the DSET-developed test method for its utility in predicting reliability and durability of photovoltaic modules. After more than 20 years in industrial and Government contracts work, I have become used and matured to the ending and the completion of programs, changes in priorities, loss of funds, all of the time, but at the recent industry program integration meeting at JPL in which we were first informed of the termination of our test contract, a JPL test engineer on the photovoltaic program announced that his group hoped that the Jet Propulsion Laboratory would become the "test center" for photovoltaics.

In 1975, DSET performed tests of two generic types of high performance solar collectors for industry on a regular basis, and I say "for industry." In 1977 two National Laboratories began testing these collectors at taxpayers' expense. In one case, our commercial work diminished, and in another case it ended altogether. In the latter case, the National Laboratory decided to fund some of their work with DSET, which induced us to construct a more sophisticated test facility. It now stands unused and unamortized with only three commercial tests ever having been performed using it.

In the summer of 1980, DSET responded to a solicitation from DOE-Lawrence-Berkeley Laboratories for constructing a passive solar cooling facility for hot/arid climates. DSET was one of the four or five bidders. DSET's proposal was judged technically acceptable and at a debriefing we were advised that we were a very close second, yet the project for just under $1 million was awarded to the University of Arizona's Environmental Research Laboratory. In fact, in that debriefing we were told that had the University of Arizona not bid, DSET would have been awarded the contract, this in spite of the fact that the solicitation stipulated that a favorable bias would be given to respondents who indicated a willingness to use the facility for followup, private commercial testing.

Confronted with the realities of de facto competition from federally operated laboratories, and of Government-supported university testing, private sector laboratory managers are extremely reticent to risk capital on test markets so totally distorted by unfair competition. It is this reticence that, in magnificient circular logic, has caused federally operated agencies and laboratories to historically justify their own commercial test activities. They become so convinced of the rightness of their activities that they develop a myopia-induced belief that they and they alone possess the only true competence—even when surrounded by equal or better capabilities in the private sector. They are quite willing to turn high-technology testing over to the private sector when the need or volume drops below the level that makes it suicidal for private sector organizations to risk capital. They then use this reticence to justify their continued activities that could be more expeditiously handled in the private sector. While this practice appeared to be declining in Federal laboratories involved in energy technologies during the past couple of years—largely as a result of increased aggressiveness on the part of private sector laboratories—the significantly reduced budgets for Federal laboratories is, it appears to us, causing a return to a circle-the-wagon philosophy at the National Laboratories.

In conclusion, the Federal agencies and Federal laboratories must be made to realize that when they distort an existing or potential market with direct or indirect competition, they tend to force a larger and larger dependence on Federal funds for survival of the activity.

The concomitant tragedy is that twin process of the public-supported competition with high-technology, innovative small businesses, and the resulting forced reliance on public sector support, displaces both capital and technology from useful, productive roles, creating a serious escalation in the loss of capital available for productive growth in the United States. It is no wonder that more and more technology is being imported as this Nation gradually loses its ability to stimulate innovation and reduce it to practice.

Perhaps part of the problem lies with the dual and rather misguided attitudes on the part of Government and Government-supported organizations that: (1) They have a mandate to support certain tasks because they can do it better and, after all, they have purer motivations as a result of being in public service; and (2) having justified their actions on this basis, they believe they owe it to the public to impose their own activities and views on private industry. For Federal organizations to assume that they have a moral justification to perform any task that could be performed as well in the private sector is a gross case of group delusion. In reality, the purifying nature of a free marketplace on the integrity of services and products provides far greater consumer protection and satisfaction than when the same products and services are provided by a public organization that enjoys a larger measure of immunity from legal and financial accountability.

One must ask responsible citizens of the United States, long the leader of the industrialized free world, why have we allowed ourselves to develop such an adversary relationship between business and Government, seemingly in total disrespect for our Nation's heritage? The disastrous consequences of this condition are only now beginning to be felt as U.S. industry finds it increasingly difficult to compete in international markets with products from nations which have quite another relationship between industry and government, that of a cooperative partnership.

In closing, I thank you for this opportunity to make my views known, and I sincerely urge the Congress to adopt the joint resolution of Senator Hayakawa and Congressman Dreier, and to reaffirm OMB Circular A-76 which prompts the public sector to rely upon the private sector in the purchase of services. Thank you.

Senator HAYAKAWA. I am very grateful to you, Mr. Zerlaut, for your well-argued testimony.

[The prepared statement of Mr. Zerlaut follows:]

STATEMENT REGARDING GOVERNMENT COMPETITION WITH SMALL BUSINESS

Gene A. Zerlaut, President
DSET Laboratories, Inc.

My name is Gene A. Zerlaut. I am President of DSET Laboratories, Inc., a private-sector small business and an internationally known materials weathering and solar device testing facility located approximately 30 miles north of Phoenix, Arizona.

With more than 60 employees, DSET Laboratories, Inc. represents the largest and one of the most sophisticated outdoor weathering and solar testing facilities in the world. Since 1973 the operation has nearly quadrupled in size. DSET operates and maintains seven exposure sites located in various geographical and climatological regions of the United States. These sites represent major end-use marketing areas for its clients. DSET currently has more than 200 hydronic, aerothermal, nonaqueous and photovoltaic solar collectors in various stages of testing, and many thousands of samples on exposure. This work in process represents the efforts of some 600 industrial and governmental clients located in 23 countries including the United States. As of July 1981, DSET had performed more than 2,000 thermal efficiency tests on flat plate and concentrating solar collectors.

DSET is best described as an innovative and aggressive, high-technology, growth-oriented small business organization--characteristics which we believe are responsible for our success in building an internationally respected organization in just a few years.

The embarcation in early 1975 upon what has become a substantial expansion plan is testimony to the faith we have in our technical and marketing capabilities and in the future of solar energy in particular--which has been responsible for more than 60% of our growth. However, this growth would not have been possible without large investments in new facilities and staff that has, in turn, required the assumption of considerable debt and the risk associated with it. Funds for the purchase of more than $700,000 in scientific and engineering facilities, principally for solar energy device and materials testing, were made available largely through loan guarantees from our bank and the Small Business Administration. DSET is the recipient of one of the nation's largest SBA guaranteed solar loans.

* * * * *

Recognizing that our well known capabilities in outdoor exposure testing of materials could serve as an initial focal point for, and an entry into, solar device and solar materials testing, DSET began the thermal testing of hydronic (water) solar collectors in the summer of 1974. From the outset, DSET has been plagued by public-supported and tax-favored competition that has forced us to artifically suppress our test fees to a degree that does not allow us a reasonable return on investment. Shortly after construction of our first test facility in early 1975, we began to receive pressure from clients and potential clients to not charge substantially more than the fees charged by a competing major state university.

The increasing national interest in solar energy, coupled with the steady increase in large and small companies being formed to manufacture collectors, began to attract more and more universities to what they thought to be the "lucrative business of commercial solar collector testing." Indeed, several universities contacted us to find out how to construct a test facility that would meet the then emerging National Bureau of Standards (NBS) test methods (NBSIR-74-635) and the subsequent American Society of Heating, Refrigeration and

Air-Conditioning Engineers (ASHRAE) Standard 93-77. We informed them that we would offer our expertise to the construction of a facility such as ours, but only if it would be employed exclusively for educational and/or research purposes. We have never had a "taker" for this offer.

Under this pressure from universities, DSET had to maintain its test fees at below a break-even level until early 1978, and at little more than break-even levels since. However, at the same time, the competition from the university sector, as well as from more and more private-sector laboratories entering the test market, coupled with changing requirements and changing designs, forced us to build still additional facilities to stay in business to protect our original investment. Also, because of the imprimatur of "officialness," professional credibility, and prestige that a university--especially a state university--enjoys in the marketplace, we believed the threat of tax-supported competition could be met only with the very finest in facilities, staff, and training. In this respect, we have always recognized that DSET, as a commerical laboratory, suffers a legal exposure pertaining to the implications of its test reports that does not accrue to university and public-sector laboratories. In protecting ourselves in this regard, it has been necessary for us, and for other commercial laboratories testing collectors, to purchase instrument calibration facilities and to implement procedures that still do not exist in most university "test" laboratories--all of which must be amortized through fees to client organizations.

Thus, although our prestige has steadily increased and our business has grown, the constant competition from the university sector, the consequences of a number of federal activities that have had an adverse effect on DSET, competition from National Laboratories, and the emergence of the Florida Solar Energy Center, a state-supported, university-operated "official" test laboratory, have all caused us to believe that at this point we may never amortize our solar collector test facilities.

FEDERALLY SUPPORTED COMPETITION

Several government activities have served to disrupt (if not destroy) the "free marketplace" for DSET and other commerical test laboratories in solar device testing. These involve the National Bureau of Standards (NBS), the Department of Housing and Urban Development (HUD), the Department of Energy (DOE), and several of the National Laboratories. A good example is the university-operated Florida State test laboratory at the Florida Solar Energy Center, discussed below.

National Bureau of Standards

In May 1975, the National Bureau of Standards issued a "Sources Sought" notice in the Commerce Business Daily seeking laboratories for what was to be the first of two Round Robin solar collector test programs. Twenty-three laboratories responded (four government, five manufacturers with captive laboratories, three commercial laboratories, and eleven universities). Of the three commercial laboratories, one was a major for-profit research corporation (who no longer offers such a test service), one was a major aerospace/air frame corporation (who only rarely performs commercial tests), and the other was DSET (then with 24 employees). Of the eleven universities, only two are believed not to have proceeded with offering a contract solar collector test service. Several used their participation as an official government sanction--that is, as the imprimatur of official approval of their organizations.

When we learned that the National Bureau of Standards intended to eventually launch a solar test laboratory accreditation program under the auspices of National Voluntary Laboratory

Accreditation Program, and that they had initiated a "de facto laboratory accreditation" effort under outside contract, we were alarmed that these processes would steadily legitimize university testing--further depressing the test market fee structure. In August of 1976, I wrote to the National Bureau of Standards with two major concerns--that of accrediting laboratories without due consideration to the conflicts-of-interest question and the restraint of trade associated with the accreditation of state laboratories.

I emphasized that, in order to truly protect the public, laboratories accredited to test solar devices for product certification should be free of conflicts of interest in terms of:

(1) possessing no contracts with government or industry to specify/develop/design solar devices and materials for the commercial market;

(2) possessing no consulting associations having the same objective as (1) above; or

(3) possessing no financial connections with any manufacturer engaged in the type of solar devices being certified, or with any corporation engaged in the specification of commercial products.

The principal evil associated with such conflicts relate most importantly to the objectivity of persons and laboratories so prejudiced--and, therefore, to the veracity of test results provided.

We also expressed concern that the national accreditation of state and federal laboratories to test in support of either formal or de facto product certification programs would function to restrain free trade:

(1) by interposing government into a marketplace where reputable private sector laboratories already exist, and where the existence of a free market is a necessary prerequisite to induce them to risk capital to construct the necessary facilities, and

(2) by creating an attractive mechanism for use of the government's name, whether federal or state, to promote a solar device or product tested by the government laboratory--thereby giving that product an unfair advantage in the marketplace over an equally good product tested by a non-governmental, private sector laboratory! (The power of suggestion is enormous.)

In subsequent conversations with representatives of the National Bureau of Standards concerning my letter, I was told that the Bureau's only interest was in the technical qualifications of laboratories seeking "accreditation." In the case of state university laboratories, my concerns have proven quite correct--the NBS subsequently approved the Florida Energy Center for HUD Hot Water Cycle tests. The interposition of that state test laboratory into the national test market has had most serious consequences for DSET Laboratories and other commercial solar test laboratories now on the scene. In addition, apparently in violation of its own policy on approval of laboratories, the National Bureau of Standards subsequently issued a list of "Approved" laboratories that has substantially affected DSET's ability to compete equitably.

While the National Bureau of Standards has subsequently expressed empathy for and a sensitivity to DSET's position--in part as a result of my testimony before the SBA Advocacy Task Group on Government Competition, and the beneficial dialogue it has engendered, their cavalier involvement in assessing the qualifications of solar test laboratories stands as one of the most damaging to DSET of all government activities to date.

Department of Housing and Urban Development

By the summer of 1977, DSET had become recognized as the foremost solar collector test laboratory in the U.S., if not in the world. However, at about this same time, HUD initiated the various Hot Water Cycle collector programs beginning with the Solar Hot Water Initiative (SHWI). The SHWI required the submission of test results from "independent test laboratories" and on the basis of laboratories approved by the NBS, they issued an initial list of ten HUD-approved laboratories, including a number of universities. Three of the laboratories listed had not tested more than one or two collectors. We understand that one actually had never tested a collector up to that time. One, a university, actually had the temerity to ask DSET to help them identify equipment needed to test to ASHRAE 93-77 (the test method specified in the SHWI requirements). Subsequently, the HUD list was widely circulated in the industry and immediately became a de facto accreditation without distinguishing the good from the merely adequate or bad. In one "stroke of the pen" DSET was reduced to a least common denominator with labs with essentially no experience in solar testing.

Department of Energy

In an effort to help in establishing a national solar collector testing, rating and certification program, the Department of Energy decided to fund a massive solar collector test program in companion RFP's and procurements issued in early 1978--one was a solicitation of ten laboratories, and the other a solicitation of manufacturers on the basis that DOE would share in the test costs (many manufacturers thought the test costs would be fully funded, and nearly 200 manufacturers indicated an interest). The laboratory solicitation indicated that these collectors would be divided between laboratories in different parts of the U.S.

Almost immediately after this announcement, our test orders began dropping and clients began delaying their plans--in several cases manufacturers actually cancelled test programs they had intiated in order to "get the free testing" promised by DOE. This new pressure came just after we had placed into operation a new $50,000 dual-collector test station.

We accurately saw this program as a major distortion of our test market and seriously considered challenging the procurement on the basis that it constituted federal interference in the private-sector marketplace. Our view was that this procurement essentially took the entire market and, it appeared to us, divided it between ten laboratories (which we know did not share equally in the then current market).

DSET accurately saw this program as one in which the best we could hope for was to minimize our losses. None of the alternatives were attractive:

(1) We could have just not responded--and lost nearly all of our test market for 1-1/2 to 2 years (which would have destroyed the company); or

(2) We could have bid it "straight," charging DOE what the program was worth--and probably lose a large portion of our fair share of the test market (for 1-1/2 to 2 years) to the university sector (with equally disastrous results); or

(3) We could have attempted to stop the procurement on the basis of public/government interference in our "free market" with the certainty that we would have strained our relationship with DOE and ruined our business with industry for stopping their "free" tests.

We chose a fourth alternative which was to bid the project at essentially little or no profit in the hope we would garner as near as possible our then current market share of testing (to maintain our cash flow needs and to not abrogate our position in the test marketplace). We were subsequently awarded a fair share of the collectors--with the requirement that the program be completed in an extraordinary short time. This short completion period required that we displace and delay tests for our commercial clients, thereby creating a backlog of tests that was later cited by government officials as evidence that public sector (university) testing was not detrimental to our market and was justification for continued encouragement and support for university test facilities.

In order to meet this new obligation in a timely manner and our responsibilities to those of our clients who were also testing for certification under the then new California Testing and Inspection Program for Solar Energy (TIPSE), we were forced to construct a third dual-loop test station. However, some manufacturers dropped out of the DOE program on learning that they had to pay 50% of the test costs--and DSET was ultimately given approximately 60% of the original contract amount--with the collectors delivered from six to nine months after they were promised. These events, coupled with a severe winter that delayed testing, forced DSET to secure a major SBA loan in order to survive.

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Two years ago our attorneys contacted a number of universities who offer commercial solar collector test services and, on stating that they were counsel for DSET Laboratories and were advising the university that DSET considers their test services to represent unfair, tax-favored competition, they replied--to a university--that they test collectors because the Federal Government has encouraged them to do so. One university defended commercial testing on the basis that they were brought into it by the HUD Solar Hot Water Initiative program, others that they were encouraged to "get into commercial testing by the NBS Round Robin Collector program," one that they were asked by the NBS to participate in the Round Robin, and another university in the process of setting up a solar collector test laboratory stated that "DOE is pushing universities to test solar collectors."

In counterpoint, an examination of the files of the then 200-member American Council of Independent Laboratories failed to find any evidence that the same vigor was applied to the private laboratories sector--or that any were contacted at all.

The Florida Solar Energy Center

We learned too late to comment on the Florida legislature's intentions in 1975 to create the Florida Solar Energy Center to certify and test solar collectors. In 1975-1976, DSET had by far the greatest number of its clients from the State of Florida. However, since October 1976 when FSEC commenced commercially testing solar collectors, our Florida-based clients have dwindled from more than 25 to two or three. As part of the State University System, FSEC was administered by the Florida Board of Regents with support services provided by the University of Central Florida in Orlando. I understand that recently administration of FSEC was transferred to another state office directly under the Governor of Florida.

If the Florida legislature is the mother of FSEC, the Department of Energy might be said to be the midwife--through extensive grants and contracts that help to sustain them in the dual role of product certifier and test laboratory, certifying largely their own tests. This has happened while DOE publicly expresses concern about the potential for harm in a threatened proliferation of state laboratories and certification programs by other states.

The decision to test with FSEC is made infinitely easier for our clients and potential clients by virtue of the facts that: (1) FSEC imposes a $300 collector surcharge on the manufacturer for "processing" other laboratory's test reports,

(2) FSEC tests carry the imprimatur of the state insofar as the FSEC is designated as the official solar product certification body for Florida, (3) having no facilities to amortize and being tax supported, FSEC charges less than do commercial laboratories for comparative tests, and (4) FSEC data is, of course, not restricted to use in the State of Florida and is used nationwide in the California TIPSE program, HUD programs, etc. We have thus lost a number of our clients to FSEC who wish to market collectors in Florida--even though they are located in many other states.

* * * * *

The relationship between DOE and FSEC has harmed DSET in other, more pervasive ways. In early 1977, the Solar Energy Industries Association was requested by the Federal Energy Administration, which later merged into the Department of Energy, to furnish a proposal aimed at the development of a solar collector testing, certification, rating and labeling program that would eventually support the contemplated tax credit program for solar in the United States. A comprehensive proposal was prepared and funded by DOE in the fall of 1977. The SEIA-proposed program was managed by the affiliated Solar Energy Research and Education Foundation (SEREF) and included provision for consumer participation and due process in the development of its methodology. The proposal included a comprehensive technical basis for rating collectors based on the existing ASHRAE Standard Test Method, for reliability and durability assessment, for laboratory accreditation, for product certification and for experimental validation of the energy rating procedure. The only task that DOE did not fund was the experimental validation of the rating procedure.

Almost immediately after SEREF developed the energy rating methodology, DOE and the National Bureau of Standards began quarreling with the technical basis for the rating procedure, effectively delaying the implementation of an industry-developed National Product Certification and Rating

Program. Yet, neither agency pursued an experimental validation phase that very early would have answered the question once and for all. Consequently, the SEREF/SEIA methodology has never been validated. At approximately the same time, the Department of Energy awarded the Florida Solar Energy Center a grant to operate what is now known as ISCC--the Interstate Solar Coordinating Council--to develop its own product certification program which ultimately competes with the industry program. The other primary goal of the ISCC program was a good one, the development of reciprocity between the states in terms of the various state tax credit programs.

However, in my opinion, no single action by industry or government has hurt the solar industry more, or has served to delay industry efforts to commercialize its technology to a greater extent, than has the "game" that DOE and the NBS played with SEIA and SEREF in their refusal to accept the SEREF rating methodology in 1979. Put another way, the various States' that participated in the ISCC program simply would not accept a SEIA/SEREF rating method that DOE and NBS impugned. Furthermore, the Florida Solar Energy Center, as the grantee for the ISCC program, operated in a dual role as test laboratory and official certifier of solar products for the Florida State Certification program that was and is still competitive with the SEIA/SEREF rating program. Thus, DOE has aided and abetted the consolidation of the position of the university-operated Florida Solar Energy Center in what we consider to be a conflict of interest that, in my judgment, operates to the restraint of free choice on the part of DSET's and other laboratories' clients and potential clients, and therefore unfairly restricts the private sector market and access to that market.

In two subsequent events pertaining to DOE, ISCC and the Florida Solar Energy Center have conspired to place DSET in still further financial jeopardy. In 1980 SEIA formed the Solar Rating and Certification Corporation (S.R.C. Corporation) to operate the national umbrella solar collector rating and labeling program. However, DOE stated that if SEIA wanted the program to succeed, and wanted DOE support, SEIA would have to involve ISCC representatives in its policy decisionmaking. SEIA's response was to accept ISCC representation on the S.R.C. Corporation board of directors. In connection with this decision, it was agreed that collector test reciprocity would prevail and all states would accept S.R.C. Corporation collector tests performed by S.R.C Corporation-accredited laboratories. In the meantime, DSET was persuaded by industry clients, by the Air-Conditioning and Refrigeration Institute (ARI)--who is a potential participant in S.R.C. Corporation, by the President of the S.R.C. Corporation, and by its own assessment of the trend in testing to construct a $250,000 solar simulator facility that would have the advantage of controlled environment testing of solar collectors--long recognized by the industry as a prerequisite for obtaining uniform and equitable test results.

Encouraged by the agreement between SEIA and the states (ISCC) that tests accepted by S.R.C. Corporation would be accepted nationwide, we were prompted to risk capital on the basis of our simulator design. We secured a major addition to our SBA-guaranteed loan and constructed the most sophisticated multi-lamp solar simulator facility in the world. Then, on the basis of a very formal evaluation program administered by the California Energy Resources Conservation and Development Commission, we applied for and were granted accreditation of our simulator test facility by the State of California and the S.R.C. Corporation. But alas, the Florida Solar Energy Center has steadfastly refused to accept simulator results in spite of the fact that they are a party to the ISCC/S.R.C. Corporation accords.

Florida Solar Energy Center's refusal to accept DSET's simulator results has effectively prevented use of the DSET simulator on a national basis. This arises from the simple fact that no national manufacturer who wishes, or may wish, to market collectors in the State of Florida can afford to obtain either S.R.C. Corporation or California certification on the basis of tests performed in a simulator, since FSEC will require non-simulator testing anyway. It is instructive to note that significant use of solar simulators would effectively render outdoor testing less desirable due to the exigencies of weather and the greater uncertainty in results due to widely variant ambient conditions. FSEC has recently noted that they will consider the simulator test results provided DSET submits a copy of its application to the California Energy Commission and copies of test results for collectors tested outdoors and also in the simulator. This has resulted in the necessity for securing solar collectors from outside sources and performing tests at great expense and time, causing a further delay in using our simulator. While we have no objection to accreditation procedures and requirements in general, it is noteworthy that FSEC did not and, to our knowledge, has never required a formal application of DSET or any other laboratory for acceptance of their outdoor tests results. Further, FSEC's requirement contradicts FSEC's general basis for acceptance of test results. The method required by Florida for thermal performance test of solar collectors is ASHRAE Standard 93-77, which allows solar simulators as an acceptable test method.

National Laboratories

DSET has, since 1974, watched the gradual build-up within the National Laboratory structure of testing capabilities that have existed at DSET Laboratories and at other laboratories in the American Council of Independent Laboratories. Between

DSET and several similar outdoor environment test laboratories in the U.S., more than fifteen private-sector, small business-owned exposure test sites have been operated for up to 30 years. Yet, to the best of our knowledge, not a single test demonstration solar array has been placed at these commercial sites, and most of them have been set up by the National Laboratories from scratch, including several at university and university-operated facilities.

Several of the National Laboratories have operated tests facilities for industry where the capabilities exist in the private sector and where the necessary government-funded testing for industry could have been performed under contract in the private sector. One case is the Jet Propulsion Laboratory's testing for the National Photovoltaic Program. DSET has enjoyed a small program from JPL for the past three years dealing with environmental stress testing of photovoltaic modules. Citing a cutback in funding and a change in test philosophy, JPL has discontinued our test contract only a few short months after we jointly presented a paper in Europe in which JPL cited the DSET-developed test method for its utility in predicting reliability and durability of photovoltaic modules. At the recent industry Program Integration Meeting at JPL in which we were first informed of the termination of our test contract, a JPL test engineer on the photovoltaic program announced that his group hoped that the Jet Propulsion Laboratory would become "the test center" for photovoltaics.

In 1975 DSET performed tests of two generic types of high performance solar collectors for industry on a regular basis. In 1977 two federally-funded National Laboratories began testing these collectors at taxpayers' expense. In one case, our commercial work diminished and in another it stopped altogether. In the latter case, the National Laboratory decided to fund some of their work with DSET, which induced us to construct a more sophisticated test facility. It now stands unused and unamortized with only three commercial tests having ever been performed using it.

MIT Lincoln Laboratory, a largely DOE-funded National Laboratory, issued a solicitation in early 1980 to construct and operate the Southwest Residential Photovoltaic Experiment Station. Although technically acceptable, DSET and another private laboratory lost to New Mexico State University on price. The principal task is testing PV systems. The imprimatur of federal government has thus accrued to another state university for product testing. It should be pointed out that our own state university (Arizona State University) involved DSET for the testing phase of their proposed program--a proper relationship between the university and private sector communities.

In the summer of 1980, DSET responded to a solicitation from DOE-Lawrence Barkeley Laboratories for constructing a passive solar cooling facility for hot/arid climates. DSET was one of four or five bidders. DSET's proposal was judged technically acceptable and at a debriefing we were advised that we were a very close second--yet the project for just under $1 million was awarded to the University of Arizona's Environmental Research Laboratory. This in spite of the fact that the solicitation stipulated that a favorable bias would be given to respondents who indicated a willingness to use the facility for follow-on, private commercial testing.

SUMMARY

Confronted with the realities of de facto competition from federally operated laboratories, and of government-supported university testing, private sector laboratory managers are extremely reticent to risk capital on test markets so totally distorted by unfair competition. It is this reticence that, in magnificent circular logic, has caused federally operated agencies and laboratories to historically justify their own "commercial" test activities. They become so convinced of the "rightness" of their activities that they develop the myopia-induced belief that they and they alone possess the only true competence--even when surrounded by equal or better capabilities in the private sector. They are quite willing to turn high-technology testing over to the private sector when the need, or "volume" drops below the level that makes it suicidal for private sector organizations to risk capital. They then use this reticence to justify their continued activities that could be more expeditiously handled in the private sector. While this practice appeared to be declining in federal laboratories involved in energy technologies during the past couple of years--largely as a result of increased aggressiveness on the part of private sector laboratories, the significantly reduced budgets for federal laboratories is, it appears to us, causing a return to a "circle-the-wagons" philosophy at the National Laboratories.

* * * * *

Federal agencies and federal laboratories must be made to realize that when they distort an existing or potential market with direct or indirect competition, they tend to force a larger and larger dependence on federal funds for survival of the activity. We all recognize the need for a massive federal presence in times of emergency--such as our nation's security and the grave problems that an energy deficit will cause. However, it is crucial to consider the implications of federal actions to the small business community--which is terribly vulnerable to the careless and cavalier decisions of government.

The concomitant tragedy is that twin process of public supported competition with high-technology, innovative small businesses, and the resulting forced reliance on public sector support (whether it is in commercial testing or other business areas), displaces both capital and technology from useful, productive roles--creating a serious escalation in the loss of capital available for productive growth. It is no wonder that more and more technology is being imported as this Nation gradually loses its ability to stimulate innovation and reduce it to practice.

Perhaps part of the problem lies with the dual and rather misguided attitudes on the part of government and government-supported organizations that (1) they have a mandate to perform certain tasks because they can do it better and, after all, they have purer motivations as a result of being in public service, and (2) having justified their actions on this basis, they believe they owe it to the public to impose their own activities and views on private industry. For federal organizations to assume that they have a moral justification to perform any task that could be performed as well in the private sector is a gross case of group delusion. In reality, the purifying nature of a free market place on the integrity of services and products provides far greater consumer protection and satisfaction than when the same products and services are provided by a public organization that enjoys a larger measure of immunity from legal and financial accountability.

One must ask responsible citizens of the United States, leaders of the industrialized free world, why have we allowed ourselves to develop such an adversary relationship between business and government--seemingly in total disrespect for our Nation's heritage? The disastrous consequences of this condition are only now beginning to be felt as U.S. industry finds it increasingly difficult to compete in international markets with products from other nations which have quite another relationship between industry and government--that of a cooperative partnership.

Senator **Hayakawa**. I want to make one more comment before I go on to Dr. Evans and Mr. Loupot. I spent most of my life in the university arena, and while you were giving testimony, I wondered to myself, "Why is it that the universities feel that they are the appropriate places for doing this kind of research and testing and so on?" and you answered that very, very well in the 18th page of your testimony when you say that "they believe they have pure motivation as a result of being in public service." This is one of our deep, deep snobberies in academic life. It implies that you businessmen are working for profit which is not pure motive. We are doing it simply for the sake of science and advancement of knowledge, and therefore we are purer than business. That is a fundamental prejudice of academia, that is why you have university laboratories.

Mr. **Zerlaut**. That is a large part of the problem.

Senator **Hayakawa**. I am very, very glad you pointed that out in the concluding paragraphs. I enjoyed it.

Dr. Evans, I welcome your testimony.

STATEMENT OF DR. CHARLES A. EVANS, JR., PRESIDENT, CHARLES EVANS & ASSOCIATES, SAN MATEO, CALIF.

Dr. **Evans**. Senator Hayakawa, Congressman Dreier, staff, ladies and gentlemen. I am very honored to have been asked to participate in this hearing. I would like to share with you some of the feelings and observations of the small, high technology business community.

My name is Charles A. Evans, Jr. I received a Ph. D. in analytical chemistry from Cornell University in 1967. For the next 3 years I was employed in the corporate research labs of Kennecott Copper Corp. Between 1970 and 1978 I was on the professional staff and faculty of the University of Illinois in Urbana-Champaign, where I was responsible for the normal teaching duties of a faculty member, as well as the typical research activities that most faculty members pursue. In addition, I was responsible for the operation of a chemical analysis laboratory on campus which provided services to other university research programs.

Another member of the staff, Mr. Richard J. Blattner, and I saw the opportunity in about 1977 to establish our own private analytical laboratory based on some of the concepts that we had developed over the previous 7 years. We were able to implement these discoveries by purchasing commercially available and recently introduced instruments, one called the IMS-3f Ion Microanalyzer manufactured by Cameca Instruments in France. We were the first company in the United States and second in the world, to obtain this piece of equipment which at the time cost $350,000. We have since been using this equipment in service and research for academic, industrial, and government laboratories, and our client list includes people from all three areas. Our innovative growth over the past 3 years can be measured by our addition of 2 more instruments, capital value of about $1.2 million, and the fact that today the company has 12 full-time employees.

As small businessmen operating at the cutting edge of technology, we are impacted by the Federal Government in three areas: regulation, taxation, and unfair Government competition. Because of the interests of this committee, I only wanted to mention regulation and taxation because they have had an effect. The most heinous of all in our type of business, however, is unfair competition sponsored directly or indirectly by the Federal Government. We feel that the direct competition issue has been very well addressed by the Senate-House joint resolution introduced by each of you gentlemen for which the small business community is very grateful.

I would like to address now the indirect competition issue. Generally, indirect competition comes about from grants and contracts let to universities and other federally sponsored laboratories, as well as the national laboratories, as Mr. Zerlaut has said. They purchase equipment with tax revenues from the Federal Government—much as we have in our laboratory with private capital—in an attempt to grow, innovate, or, in some cases, build empires. For a variety of reasons they have gone outside the academic research community to find users of this equipment. They then offer these commercial services at a very unfair rate because they do not have to recognize the cost of equipment, they operate in university facilities at little or no charge, and they can use graduate student, professional staff, or faculty labor, which does not have to compete in the private sector. As such, State and local governments become "coconspiritors" insofar as they underwrite a portion of the costs.

I have submitted to your staff a written document which I would like to request be entered into the record.

I would like to summarize in the next few minutes some of the issues addressed by this document.

For the record, the establishment of any small business requires initial capitalization sufficient to sustain operating costs until suitable revenues can be established to meet the demands of cash flow. Small business must purchase equipment, paying any and all associated taxes, usually involving financing through a lending institution. Staff must be hired as needed in competition with the largest corporations in the United States. Every step of the way the founders and investors are constantly at risk. The interest charges incurred must be paid, but cannot even be recognized by those companies subject to Government accounting principles. How can all of these real costs which burden the small businessman even be recognized by a university laboratory? They can operate a half million dollar instrument for a mere $20 or $30 an hour—mainly to reimburse technicians' salaries and maintenance costs—while we must charge around $250 an hour to recoup the real expenses of every day's operation. Should we be fortunate enough, we would also have to pay income tax on any profit. There are many costs associated with an operation like ours that do not occur, for example, in a university setting. They have numerous insurance policies. Our lending institutions require that we have earthquake insurance on our instruments because we are located in California. We have to have a fire alarm system. We are required to have large life insurance policies on Mr. Blattner and I, to cover our outstanding indebtedness should one of us die, which dramatically impacts the company. None of these types of expenses are necessary for a federally funded facility operated in competition with us.

Why does the academic community go into competition with the private sector? Mr. Zerlaut has addressed this issue, as well as Senator Hayakawa, as one of pure motivation. However, there are real financial reasons why they do. The National Science Foundation over many, many years has funded equipment, such as scanning electron microscopes, mass spectrometers, and so forth, that is at universities in order to promote and further science in our country. As time goes by, they continue to proliferate the amount of equipment available, but they do not necessarily provide the funds needed to operate, maintain and staff these instruments on a continuing basis. Rarely is an expensive scientific instrument ever decommissioned except for the lack of people to operate it. It is not uncommon for a university to get a piece of equipment this year costing $500,000, via Government funding, and not even have a person to operate it the next year, because there is no staff financial support. Thus the managers of these laboratories must turn to the private sector to generate revenue to maintain and operate these facilities intended for graduate student research. The National Science Foundation has tried to meet this problem by establishing regional instrumentation facilities. Although these facilities are supposedly competitively bid by the entire technical community, in all cases they have gone into university laboratories. These facilities are designed to reduce the economic impact of modern research on the university because of the high cost of equipment. Fundamentally, this is a good idea. Unfortunately, even these regional instrumentation facilities are going into competition with the private sector.

In particular, I would like to quote to you from the proposal submitted by the University of Minnesota (an NSF recipient) on becoming a RIF user. It says:

> In the case of analytical service requests, the procedure (for getting work done) will be shorter and quicker. The request can be simply for a number of hours or for a number of samples * * * If the time requirement is one-half day or less, the service will be carried out within 3 weeks of the request,

which seemed to me to imply very routine testing.

Analytical time of a few hours can hardly be considered a forefront research program. However, the key here is that they are not going to serve just the academic community. With respect to proprietary research, the University of Minnesota will attempt to devise a proposal review process that will preserve industrial confidentiality and at the same time preserve the university's requirements of collegiality. One of my colleagues defines "collegiality" as "meeting in the coffee room at 3 o'clock to discuss what is going on."

The funding of a proposal which says that a university operating with Federal funds is going to provide proprietary industrial research belies the National Science Foundation guidelines that all uses of the RIF's should be of a fundamental science nature and be published in the open, peer-reviewed scientific literature. The Minnesota proposal even had provisions for the university to charge the industrial user an amount that reflects the cost of university facilities, that it, only a very small fraction of the true costs which must be recognized by private companies doing comparable work. These programs that are leading to unfair competition by and large are not being conceived by malicious, malevolent or evil people, they are people who are either economically forced into competition or are extremely naive. As Senator Hayakawa and Mr. Zerlaut indicated. They are lead into believing that they can benefit science, technology, and the private business community better than the private business community can serve itself.

We feel the Department of Energy is another matter. The Department of Energy is actively promoting its facilities at national laboratories, such as the Jet Propulsion Laboratory, and the recently established Solar Energy Research Institute, and at universities. The University of Illinois, where I was once faculty and staff member, now is going into competition with us and offering services at a cost dramatically below that we must charge to our customers, either academic or industrial.

In summary, we are only just now beginning to feel the effects of this competition. We have been innovative, but as time goes by, the unfair competition from not-for-profit research laboratories, universities, et cetera, will be our undoing. Ironically, they will be using the innovations developed in our laboratory, that we have contributed to the advancement in science and technology in the United States. It is not that we are fearful of legitimate competition. Our difficulties arise solely from the public sector offering comparable services at subsidized rates. We would be happy to compete with any laboratory provided we all played by the same rules. As Mr. Zerlaut has testified earlier, if the public sector wishes to go into competition, they should be subject to the same economic constraints that we are, not protected by Federal Government-purchased equipment, guaranteed operating expenses, and so forth. Such unfair competition undermines the basic fabric of a free enterprise system, and as such is at best misguided. Thank you very much.

Senator HAYAKAWA. Thank you, Mr. Evans. Your testimony really shakes us up.

[The prepared statement of Dr. Evans follows:]

STATEMENT OF

DR. CHARLES A. EVANS, JR., PRESIDENT
CHARLES EVANS & ASSOCIATES

My name is Charles A. Evans, Jr., President of CHARLES EVANS & ASSOCIATES, a small, high-technology company offering state-of-the-art materials analysis services to the American R/D community.

I would first like to express my appreciation to the Subcommittee for giving me the opportunity to testify on behalf of small, high-technology firms like ours who are continually frustrated and even threatened by thoughtless or insensitive intrusions by the Federal Government into the private sector. Before detailing my observations and concerns regarding this issue, I should take a moment to briefly describe my background and that of our company to give you a perspective on the experiences which form the basis of these opinions.

I received a Ph.D. in analytical chemistry from Cornell University in 1967. The following three years were spent as an analytical chemist and research scientist at the Ledgemont Laboratory, the corporate research laboratory of Kennecott Copper Corporation. I left Kennecott in 1970 to join the professional staff of the Materials Research Laboratory (MRL) at the University of Illinois, a Federally funded, multidisciplinary materials research laboratory. As Senior Research Chemist, I supervised a group responsible for providing analytical services and research support to other groups within the MRL as well as other faculty research programs campus-wide. As the direction of research within the laboratory changed from an emphasis on bulk materials characterization to surface and thin-film related phenomena, I was integrally involved with reorganizing the MRL central facilities and adding new advanced instrumentation to meet these challenges. During the six years from 1971 to 1976 the number of major instruments in our group doubled from two to six.

In addition to supervising the MRL chemical analysis facility, I was also responsible for managing a parallel research effort which included the professional staff, graduate students and post-doctoral fellows, many of whom have gone on to become distinguished scientists in their own right. These research programs were funded by the MRL (through the National Science Foundation and Department of Energy) or by direct grants obtained competitively from the National Science Foundation, the National Institutes of Health and the Environmental Protection Agency. As a result of these highly successful programs, I was appointed Associate Professor of Chemistry with full faculty rank and promoted to Principal Research Chemist on the professional staff of the MRL. It was this research and the development of new analytical capabilities and applications in a university setting that ultimately led to the establishment of Charles Evans & Associates, via the natural route of technology transfer in the spirit of free enterprise.

In 1977, Mr. Richard J. Blattner (a member of my group at the MRL) and I conceived the idea for a new commercial analysis and research laboratory predicated on the results of our research efforts over the previous years. The key ingredients in this new business venture were a newly announced, second generation secondary ion mass spectrometer (purchase price $350,000) manufactured by Cameca Instruments in France and our own expertise in this field. Mr. Blattner and I assembled the necessary start-up business capital by refinancing our homes, cashing out retirement funds, withdrawing personal savings, etc. We were able to obtain financing for the full purchase price of the Cameca IMS-3f Ion Microanalyzer (including import duties and California state sales tax) from a private lending institution based on a comprehensive and compelling formal business plan, the equipment as collateral and our personal signatures as guarantors of the loan. It is noteworthy that we were the first laboratory in the U.S. and only the second laboratory in the world to have this particular instrument (the first went to Japan). Although there was a large number of existing analytical service laboratories, we were clearly differentiated from our competitors by the uniqueness and advanced capabilities offered by our choice of instrumentation. However, all the equipment that we had purchased was available on the open market and could be obtained by anyone wishing to remain completely competitive. They would be subject only to the risks associated with such a large capital investment just as we were and still are.

Since opening for business in late 1978, we have grown from 2 to 12 full-time employees and from 1 to 3 major instruments (similarly financed). Our principal product is state-of-the-art surface and thin film chemical analysis and research services to:

a) universities such as Harvard, Massachusetts Institute of Technology, Case Western Reserve, Stanford and California Institute of Technology;

b) Federal laboratories such as Lincoln Laboratory, Naval Research Laboratory, Brookhaven, Sandia, Los Alamos Scientific Laboratory and Lawrence Livermore Laboratory; and

c) numerous industrial research organizations such as Hughes, Rockwell, Bell Laboratories, IBM, Westinghouse, Xerox, Exxon and General Electric.

Our non-research oriented customers are generally involved with product development and/or failure analysis primarily of semiconductor devices and include companies such as

d) National Semiconductor, Signetics, Intel, Motorola and Texas Instruments.

Each of these companies or research laboratories is "sharing" the costs of acquiring and operating our equipment subject to normal market forces and cost justification. Conversely, each uses our facilities only to the extent needed and in the most cost effective manner. Our largest single customer spends approximately $75,000 annually with us, far less than the operating costs he would have to bear if he established his own facility. In addition, he has access to over 1.2 M dollars in capital equipment, not to mention our experience and expertise with the analytical techniques and our natural role as consultants in all facets of materials science. In some respects we bare a striking similarity to the NSF funded surface analysis Regional Instrumentation Facilities presently located at the Universities of Montana and Minnesota except that we have created the capability entirely through private capital and free enterprise.

Although we are a commercial service laboratory, it is the nature of our analytical techriques, our customer base and our personal predilections to place a strong emphasis on a vigorous corporate research ethic, a good deal of which has been of a rather "basic" character. In our company's short existence (3 years) we have authored or coauthored more than 50 peer-reviewed papers in the open literature with more currently in progress. In some cases these programs have been funded entirely with internal funds generated by our commercial business (with no tax advantages whatsoever) supporting our interest in and commitment to basic research.

As a small business we are subject to the typical pressures imposed by the Federal Government. These fall into three general categories:

1. Regulation
2. Taxation, and
3. Unfair, Tax-Favored Competition

Our business is such that regulation affects us least but does lead to an inordinate amount of "paperwork," certifications, etc., necessary to sell services to the Federal Government and its contractors. Thus its impact on us is merely to increase our overhead. However, I am certain that others can speak to the regulatory problems imposed by the Federal Government much better than I.

Taxation and tax policy is yet another matter. Two particular aspects of the tax law have seriously impacted our company: import duty and depreciation. By design, our equipment is at the cutting edge of technology. As you might expect, this requirement implies that it is expensive and in one case unavailable in the United States. Two of our instruments were manufactured in France (combined price--$800,000). When the same instruments are purchased by universities or government laboratories entry is made duty free on the basis of sole-source and their not-for-profit status. In our situation we were obligated to pay the duty (equal to about 7% of the purchase price) even though no U.S. equivalent instrument has existed for several years! We were informed that the tariff could only be changed through legislation which led us to our former Congressman, Bill Royer. At his request a ruling was made by the International Trade Commission that, indeed, no U.S. equivalent instrument existed. Congressman Royer introduced a private bill (HR 8086) but he was defeated for re-election before passage of this bill. The final indignity came in the form of a recent invoice for $2,500 for an increase in the duty as a result of reclassification a year after the instrument cleared customs and was installed in our laboratory! Such monies could be far better spent for "real" new equipment to aid in our work. We have waged a long arduous battle, unsuccessful to date, to have these unfair, ornerous duties removed and refunded since the purpose of import duty is to protect U.S. interests, not generate revenue for the Federal treasury. Unfortunately, we are forced to expend valuable time and resources in pursuits of this type not really germane to our company's primary mission. Not only must we make a substantial payout, but we are severely diverted in trying to obtain some form of relief.

Another taxation issue facing a small, capital intensive start-up business like ours concerns depreciation and tax credit incentives. We, like many small businesses buying "big ticket items", must turn to lenders for major acquisitions. Financing is generally structured much like the purchase of a home except that the life of the loan is much shorter, typically 3-5 years. Therefore, in that 3-5 year amortization time frame the borrower must repay the entire principal as well as debt service (interest), all of which usually must come from cash flow. Applying the concept of depreciation, if any of the depreciation "life" of the instrument extends beyond the lifetime of the loan (which it almost certainly will) then the company must show a profit during the payback period just to meet its debt service obligations. It then must pay taxes on that profit, which it has disbursed, from cash it does not have! One could argue that the company will have residual depreciation in later years to "shelter" revenue, but the argument assumes that the company survived to cash in on its windfall! The alternative would be to choose a depreciation lifetime equal to the lifetime of the loan (not always allowable under IRS rules). This election would almost invariably cause a forfeiture of investment tax credit which may have been one of the several justifications for making the purchase in the first place. I hope you can visualize from these brief remarks about taxation how the small businessman, and the start-up company in particular, is placed in a very defensive posture with respect to the IRS when expensive capital equipment is involved. The rules concerning used equipment are even more punitive. We do see some, but not complete, relief in the recently passed tax legislation and anxiously await the full implementation.

Although the issues of regulation and taxation are certainly sufficient to drive a small businessman bankrupt if not insane, we are all subject to the same basic problems. Perhaps the most serious issue confronting the private research laboratory community is unfair competition from government agencies, either directly or indirectly. Examples of direct competition were described by Dr. Earl H. Hess of Lancaster Laboratories in his testimony before this committee. Your efforts as exemplified by the Hayakawa Resolution are welcomed and applauded by the small business community who are extremely vulnerable to the activities of governmental agencies. The concept that the Federal Government should purchase its goods and services from the private sector at real costs is the only one consistent with the free enterprise system. With the issue of direct competition being addressed in present legislation, I would like to move on to the issue of indirect competition, one of gravest importance to the small, high technology private laboratory.

Many Federal agencies, such as the Environmental Protection Agency and Department of Energy, obtain laboratory and research services via contracts to outside entities. They may also establish "in-house" capabilities for research. Other agencies, such as the National Science Foundation, have as their prime function, the sponsorship of research in pursuit of fundamental scientific knowledge. However laudable are the goals of these agencies, they too should not conflict with the free enterprise system by fostering unfair competition with the private sector. The initiation of this competition usually takes the form of a Federal agency, often the National Science Foundation, granting to a university or other tax favored institution, the funds necessary to purchase, staff and maintain a facility providing services to the university and/or the outside research community. For one of many possible reasons, the university begins to offer these services, many of which are already commercially available, to industrial laboratories under the guise of university-industry cooperation, education, or merely because they find themselves short of funds. Each particular instance takes on a slightly different character but it seems ludicrous to suggest that corporations like Exxon or General Electric need research support from a university facility underwritten by Federal funds when these services are available in the commercial sector.

Those of us in the private analytical service laboratories see emerging issues which are causing universities and other not-for-profit institutions to enter into competition with the private sector.

1. Universities are experiencing a short-fall of operating capital such that they are no longer able to support existing facilities and must turn to the private sector in order to augment the funds made available to them by various funding agencies, both public and private.

2. There is a desire on the part of many laboratories to obtain state-of-the-art equipment which is becoming more and more expensive. Thus, the acquisition of this equipment requires a greater justification than would normally have been provided by the immediate university community. Again, they must turn to the private sector in order to obtain significantly greater numbers of users for the justification of the purchase.

3. There is, as in any discipline, raw empire building, merely to have more equipment, more people, bigger budgets, etc., without regard for the need or utility of these facilities. As before, justification requires turning to those outside the academic research community.

4. There is a misconception by industrial researchers about the role and proper use of federal funds within the research community.

5. There is again a misconception regarding foreign governments and their involvement in fostering growth of science and technology within their countries, and thus certain groups feel that our government, without real knowledge of the activities in these foreign countries and without regard for the social and philosophical differences between countries, must also foster science and technology through the not-for-profit sector.

Consequently, university and not-for-profit research institutions are receiving large sums of public money through a variety of programs. Unfortunately, most government agencies do not set guidelines for the use of equipment purchased with these funds vis a vis the private sector.

Secondly, there are few governing boards, etc., to provide direction, guidance, and/or interpretation of any guidelines as to the appropriateness of their activities. Again, the Hayakawa Resolution provides the fundamental precepts which should be taken into consideration in the granting and use of these funds. The federal government should purchase products and services from the private sector (when available) rather than establish facilities which compete with the private sector. I should mention at this point that the Department of Defense, as far as our involvement with their agencies, operates in a thoughtful, responsible fashion and has a great deal of sensitivity for the private sector. The funding agencies of the Department of Defense contract for the acquisition of basic scientific information, technology development and hardware for use by the Department of Defense. In the case of scientific research, should a particular activity require services necessary to perform the function of their contract, the Department of Defense provides the necessary funds to acquire these services just as they would acquire any commercially available product. The Department of Defense has not tried to go into the business of providing analytical services for DoD contractees. Such should be the goal of the DOE, NSF and other similar agencies.

Perhaps it is now appropriate to give some examples of the abuses that are made in the use of federally funded equipment and facilities. I must admit that it is difficult to catalogue the extent or nature of these abuses since there may be potential customers for a private laboratory who we never see because they are routinely going to the tax-favored competitor. Moreover, some are a bit embarrassed and don't discuss the matter with us since they realize they may well be improperly using these facilities.

Dr. Joseph Andrade in the Department of Bioengineering at the University of Utah has been providing ESCA services to the general scientific public. He has even published a price list and circulated it among his potential industrial customers. Another example is the use of a scanning Auger microprobe at the University of Texas-Austin. We know scientists from the Aerospace Corporation in Los Angeles who have used this facility on a commercial basis to the extent that they were able to justify purchasing their own instrument. Another example is found at the Department of

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Electrical Engineering at Colorado State University in Fort Collins. They have an Auger electron spectrometer which we know provides services to for-profit corporations at an extremely low cost totally undercutting the capabilities of the private sector. In fact, we have customers who do not use our Auger capability because they can use the CSU facilities so cheaply.

The National Science Foundation has been providing funds to universities for many years and as a result there are a host of facilities of varying capabilities available in the academic community. Unfortunately, some of these have begun to compete with the private sector as described in the testimony of others and my discussions above. The National Science Foundation has begun to recognize that competition between academic facilities and the private sector can become a problem. This recognition did not come about due to internal activities at The National Science Foundation but from groups such as the American Council of Independent Laboratories as well as efforts from private laboratories such as Structure Probe in West Chester, Pennsylvania.

Unfortunately, the enlightenment of the NSF does have its darker periods. The concerns of the private sector have been heightened by a new program at the NSF called Regional Instrumentation Facilities (RIF). The Regional Instrumentation Facility program was developed to make expensive equipment available to the research community such that the National Science Foundation would not have to buy high performance, high priced instruments for each of the universities in a given region. Unfortunately, justification for the RIF's expanded to the point that some of the proposals contained provisions for

1) routine analytical service on equipment also available in the private sector, and

2) maintaining confidentiality of proprietary research.

I quote from the proposal submitted by the University of Minnesota and funded by the RIF program at the National Science Foundation:

> In the case of analytical service requests, the procedure will be shorter and quicker. The request can be simply for a number of hours or for a number of samples....If the time requirement is 1/2 day or less, the service will be carried out within three weeks of its request, which will give the director time to rearrange schedules.

Analytical times of a few hours are hardly compatible with forefront research programs. Continuing:

> With respect to proprietary research, we will attempt to devise a proposal review process that will preserve industrial confidentiality and at the same time preserve the University's requirements of collegiality.

The funding of such a proposal belies NSF's guidelines that all use of the RIF's should be of a fundamental science nature and be published in the open, peer-reviewed scientific literature. The Minnesota proposal even had provisions for charging the industrial user of the RIF an amount which reflects only a fraction of the true costs which must be recognized by the private sector. Quoting:

> The policy on equipment time will be that academic users will not be charged for such time, but industrial users will be expected to pay a charge which will reimburse the Center for operating and maintenance expenses.

The issue of the NSF funding facilities which will undercut or price compete with the private sector as well as actually performing proprietary research has continued to expand. Recently, we received a document from general counsel of the National Science Foundation for our review which was a proposed policy for the use of facilities which might be established by the National Science Foundation. The document proposed that these facilities would be available to the academic community as well as to industrial users for proprietary and non-proprietary research and development. The proposed policy was that the NSF would not even ask the private sector user to justify the quality of the science being served if it were of a proprietary nature and this user paid "full-cost recovery" rates. That is to say, the National Science Foundation would sell time on federally supported equipment on a cost-recovery basis without any regard at all to the fundamental science contained in the activity. The naivete of the National Science Foundation in this respect was appalling.

Mr. Blattner and I responded with a 10-page, single spaced document discussing the high points, or low points, as you will, of this document. One of the most telling issues in this entire document was the lack of recognition by a federal agency in of the costs and expenses incurred by the private sector. I do not believe that this attitude is unique to the NSF but pervades Federal agencies. The NSF would have the federal government

1) purchase equipment for these facilities,

2) guarantee the operating expense whether services were sold or not, and,

3) maintain low salaries through the use of graduate student, post-doctoral or professional staff labor.

For the record I would like to spend the next few paragraphs discussing the expenses borne by a private laboratory. The establishment of any small business requires an initial capitalization such that one can sustain operating expenses until suitable revenue can be established to meet the demands of expenses. Secondly, equipment must be purchased with all the associated taxes, such as sales tax or customs duty, and usually involves financing which must be repaid from cash flow. Staff must be hired in competition with the largest corporations in the United States. At every step of the way the founders and investors are at risk and must have revenue at least equal to expenses to avoid a negative cash flow. (A condition which does not seem to bother the federal government, i.e., when did we last have a balanced budget.)

Interest, a fact of life in most small companies, is not even recognized by the federal accounting principles governing cost recognition. Thus, how could this real cost burdening the private sector, but unrecognized by the federal accountants, be included in a "full cost recovery" charging rate which the National Science Foundation would establish for their funded laboratories. Furthermore, we are obligated to pay state sales tax on all of our purchases, county personal property taxes on all of our furnishings and scientific equipment, and city license and business fees calculated as a percentage of sales. Moreover, we must make employer contributions to FICA and pay federal and state income taxes, should be lucky enough to show a profit. Would each of these taxes be included in a cost accounting scheme of the university? Of course not. Moreover, our lenders require that we carry multi-peril property insurance including special earthquake coverage in California; they require life insurance policies on Mr. Blattner and I in the amount of outstanding indebtedness; and we have been required to install a central station fire alarm monitoring system. Again, these hidden costs would never be recognized by a "full cost recovery" accounting by a federally funded laboratory.

Although the proposed policy provides lip service to the idea of non-competition, the whole concept is pretentious, naive, and impossible. The proposed policy then suggested that the National Science Foundation funded facilities might set their rates higher than the "full cost recovery" for the proprietary research so as not to undercut the private sector. I doubt that government accounting and audit procedures would permit a profit-making policy such as this. They then proposed that these profits would be returned to the Federal Treasury. This is great! Not only is the government going into business; it's going to set the rules so that it shows a profit. I'm sure that the General Accounting Office, the OMB, and the Internal Revenue Service would love this idea. I would hope that such a profit, i.e., revenue in excess of cost, would require that a host university relinquish its tax exempt status under the tax codes. No matter how good are the intentions of any federally funded laboratory, should it go into competition with the private sector, there is no way that these facilities could be non-competitive with the private sector in any field where there are existing commercial services available. Even if the facility were providing proprietary research at "full cost recovery," they would be subsidizing that proprietary research since the facility would be charging less than the cost that would be incurred if the researcher performed the work at a facility internal to his corporation or at a commercial analytical laboratory.

Even when such services are not available on the outside, we believe that government involvement in providing such a service requires serious consideration because of the possible pre-emptive position with respect to the future establishment of this capability by a private laboratory. The whole concept that the government could blithely establish a capability not available yet in the commercial sector should be addressed for there is indeed a classic example of this. We have labeled this concept the Pre-emptive Strike and this practice has impacted our potential expansion since there is a capability existing in the academic community which may prevent us from acquiring a new capability. Perhaps a bit of a discussion would help your understanding in this area.

High energy particle accelerators were developed in the 1930's and 1940's, and were closely associated with the development of atomic energy and nuclear weapons. After World War II, these facilities, many of which were Van de Graaff systems, represented the "cutting edge" in high energy technology and were used for a variety of purposes, including studies of the structure of the nucleus. However, as time went by, the utility of these facilities in pursuing fundamental high energy research were essentially exhausted. In an effort to sustain their importance (and funding), other more practical applications were sought. One application that emerged, particularly in the last 10 to 15 years, is a technique for materials analysis called Rutherford backscattering spectrometry. By and large, the only facilities available for this type of work were located at universities and government laboratories. A few major corporations, such as IBM, Bell Laboratories and Lockheed, have also had these facilities available for in-house use. In about 1977, a small U.S. accelerator manufacturer developed a relatively low cost instrument for general use. Even so, the machine is 25 feet long and costs between $350,000 and $500,000. Our company has been seriously considering purchasing such an instrument to offer commercial services, since the instrument is sufficiently complex and expensive enough to inhibit many companies from purchasing their own equipment. However, in surveying the market, we have found to our dismay that a number of potential customers are already obtaining services through university affiliations. General Electric routinely buys services at low cost from the State University of New York at Albany. Mostek Corporation, a subsidiary of United Technologies, has had work done at Baylor. The Ford Motor Company receives services from Western Michigan University as an ongoing interaction and Signetics Corporation, a recent acquisition of North American Philips, purchases services through the University of California at Berkeley.

These are examples which have surfaced with almost no detective work on our part and undoubtedly there are many other users at these facilities. In every instance mentioned above, rates are very minimal ($50-75/hr), don't reflect true costs, and usually involve faculty consulting fees. Even when the consultant costs are combined with the instrument use charge, the total in no way approaches what we would have to charge as a commercial laboratory. Furthermore, these laboratories have taken zero risk, due to public funding. Because of the presence of this overwhelming University and Government involvement with the private sector, we most likely will not expand into this new and innovative commercial service area, even though such services could affect balance of payments and would obviously benefit the U.S. equipment manufacturer. Hence, the new jobs which could be created will not exist; the economic growth and tax revenues that expansion would provide will not be realized, simply because of the existing unfair competition. This is a relatively simple but blatant illustration of how such practices inhibit free enterprise by establishing a pre-emptive position with respect to the private sector.

At this point I would like to say that the NSF has an important role in American science and technology and they have met the challenge well. I and others have benefitted professionally from their activities and American science and technology would be far short of its present level without the National Science Foundation. Recently Charles Evans & Associates, has submitted several research proposals for consideration by the NSF. The problem of unfair competition by the NSF is only representative of the naivete and misunderstanding existing in the Federal agencies. As an example, I would like to discuss recent activities by the DOE which are more recent but equally harmful.

The Department of Energy is becoming particularly competitive and is fostering direct competition with us. At one time the Jet Propulsion Laboratory, operated for the DOE by Caltech, purchased $25,000 to $30,000 of services annually from us and their use was destined t grow. Recently, JPL purchased their own CAMECA IMS-3f Ion Microanalyzer with DOE funds and is performing analyses not generally in support of internal research but for monitoring of materials delivered under contract to JPL. Other laboratories that are beginning to develop a competitive stance include the Solar Energy Research Institute in Golden, Colorado, funded by DOE and operated by the Midwest Research Institute. SERI is presently expanding their equipment at a prodigious rate. They have recently purchased a $750,000 Cameca IMS-3f Ion Microanalyzer, a CAMECA $500,000 - $600,000 electron probe microanalyzer, and at least three if not four scanning Auger microprobes. At the present time equipment purchases are on the increase as personnel is rapidly decreasing. Ironically the competition from SERI takes the form of letting a contract to us for the development of the analytical techniques necessary for them to go into competition with us.

Presently, the Material Research Laboratory of the University of Illinois, where I was once employed, is actually setting up and establishing capabilities and a price list to provide analytical services not only to the university/ academic community, but also to the private sector. We have been told that the charges to be made to private enterprise by the Materials Research Laboratory is above the actual cost of operating the equipment since the Department of Energy is funding the operation, but significantly below the charges we must assess in order to fully recover the costs of operation including return on investment. The facility operated by the University of Illinois provides services employing equipment, much of which is available in the private sector. Equipment such as scanning electron microscopes, transmission electron microscopes, scanning Auger microprobes and Ion Microanalyzers, are being used to provide services to the corporate community. This operation at the University of Illinois has been funded by Federal funds from the AEC, the National Science Foundation, Department of Energy, and other similar agencies. To me, this activity is a blatant disregard for the free enterprise system.

The issues of unfair competition to Charles Evans & Associates is only now evolving. We have not yet been as heavily impacted as other laboratories have been due to the instruments used to establish our company. We were the first laboratory in the United States and the second in the world to use the Cameca Ion Microanalyzer. So, at that point we had no competition. With our successes in the use of the technique and in the resultant advancement of science and technology by our customers, industrial, federal and university laboratories have seen the efficacy of this technique and the instrumentation and they now are beginning to get on the bandwagon. Competition for us is now on the way, not from the private sector but from federally purchased equipment. We resent the federal government setting up facilities and going in to competition. An examination of the distribution of the instruments purchased is somewhat revealing. There are six instruments in the United States purchased by federal funds. Five are at universities:

1) the Geology Department at the Massachusetts Institute of Technology;

2) the Department of Chemistry at Cornell University;

3) the Materials Research Laboratory at the University of Illinois; and

4 & 5) two at Caltech, one in the Geology Department and one in an operating subsidiary, at the Jet Propulsion Laboratory.

One instrument at the Solar Energy Research Institute, which is operated for the DOE by the Mid-West Research Institute. Thus six of the twelve instruments existing in the U.S. are being purchased by federal funds. If one examines those industries which have established that they could cost justify the purchase of such expensive equipment, we find only four of the largest corporations in America, IBM, Bell Laboratories, (a subsidiary of AT&T), General Electric, and the Mostec Divison of United Technologies. There are two other instruments in industry, the two that we have. So we see that only four corporations could actually cost justify the expenditure of hundreds of thousands of dollars for this capability, while over 100 industrial clients have evaluated the financial aspects and use the two instruments in our laboratory.

This trend is continuing for future purchases of the instruments. Kodak and Motorola-Austin will soon be receiving their instruments from Cameca while there are a host of universities which have purchased or intend to purchase these instruments. Washington University in St. Louis will be receiving one for geological research while the University of North Carolina has submitted a proposal to the NSF for purchase of a unit like ours. We understand that they fully intend to do proprietary work for industrial clents this equipment and will actually assess a charge equal to ours. Again, they will now be going into profit-making activities since our charges reflect infinitely larger costs than they would ever have to sustain since the federal government has bought that equipment for them.

Where would we be today were it not for the JPL's. SERI's, University of Illinois' and potentially the University of North Carolina's as well as all of those that we cannot yet identify having gone into competition with us? In our ion microanalyzer business, we have saturated the capability of our two instruments on the day shift. Yet, we would almost certainly have sufficient amount of demand to keep an entire instrument operational were it not for JPL, SERI, and the University of Illinois providing routine analytical services on their equipment, rather than truly performing the proper function of an instrument in an academic or research community: The support of graduate research and the furthering of scientific knowledge, not the development of technology.

About one year ago we added an Auger electron spectrometry capability to our laboratory by the purchase of a state-of-the-art instrument, costing over $300,000. We realized that it would take us a substantial amount of time to bring this capability on-line since there existed competition from private analytical laboratories. It has taken us about a year and we are just now covering expenses for this instrument. I would argue that this long delay is not due to the legitimate competition. We knew about them. But we had no idea of the pervasive nature of the competition from the University community such as those at Colorado State University the University of Texas, JPL, University of Illincis and at least three at SERI. Not only would we have substantially more business with our existing capabilities, but we would also have an entire new line of activity, Rutherford Backscattering, since there would be a fairly large, unsatisfied demand if the universities listed before were not providing services.

In summary, one could ask two questions of this whole area of unfair competition. The first might be why is it wrong for the federal government to subsidize research which should further technology in this country? The answer to this is embodied in the Hayakawa Resolution. The federal government should purchase its goods and services from the private sector in order to be compatible with the enterprise system. The second question one should ask is, given that the federal government should not compete, what should be the guidelines for the research support agencies, such as the National Science Foundation to prevent competition? I think the guidelines should be that the National Science Foundation or any other agency of the federal government should provide facilities and research services only for the academic research community. There should be guidelines to prevent the faculty members in those universities from performing their consulting activities on those instruments and to prevent the university staff and programs from becoming channels for the introduction of samples from the industrial community. If the federal government wishes to foster the develoment of technology so that the United States can remain competitive in its metallurgical, semiconductor, etc., industries, then the federal government should accomplish through the free enterprise system. For, it is the free enterprise system which can grasp a mission and bring it to fruition with a rapid delivery of capability. If academic research is required of these missions then that could be funded, either directly from the appropriate agencies or by allowing corporate contractors to let subcontracts to universities or purchasing consultation of faculty members. The most heartening thing to us is that we believe that the Congress is now headed in the right direction, that is the protection of the private enterprise system and fostering of growth by small business.

Thank you very much for this opportunity to share with you the concerns that of the small, high technology business community has over the involvement of the federal government in our business activities.

Senator HAYAKAWA. Mr. Loupot, we would welcome your testimony.

STATEMENT OF FLOYD LOUPOT, PRESIDENT, NATIONAL HEARING AID SOCIETY, LIVONIA, MICH.

Mr. LOUPOT. Thank you. Mr. Senator, Congressman Dreier, my name is Floyd Loupot, and I am here to speak today as both a small businessman and as president of the National Hearing Aid Society.

As a small businessman, I have been self-employed as a hearing aid specialist and owner of a hearing aid office for 15 years in Pasadena, Calif. In my years as a hearing aid specialist, I have helped literally thousands of hearing-impaired Americans overcome the handicap and achieve better hearing through the use of a hearing aid. As the president of the National Hearing Aid Society, I am the head of a national trade organization which represents nearly 4,000 hearing aid specialists. The National Hearing Aid Society was founded 30 years ago to insure that competent, professional assistance was and would continue to be available to this country's 20 million plus hearing-impaired citizens.

The comments I wish to make this morning represent not only my personal views and the views of the National Hearing Aid Society, but also the views of each member of the National Hearing Aid Society who is currently attempting to operate as a small business person, and believe me, they are all small people. We are opposed to Government involvement and the resulting unfair competition with the free enterprise system.

If the free enterprise system is to function as our Founding Fathers felt it should, the small business person must be given the opportunity to succeed or maybe even fail, with a bare minimum of Government involvement. Indeed, one of the cornerstones of the foundation of this Nation is laid upon the right of every individual to operate his own business or be self-employed if he so chooses to do so.

The contributions small business has made to this country in the past and is continuing to make through innovation, service, job opportunities, and dollar contributions to our national economy are well known by all of us. Perhaps not as well known to all of us is how the Government has sought to usurp the domain of the small businessman. One of the most glaring examples we in the hearing aid field have witnessed has been the entry of the Federal Government into the hearing aid delivery system. Under the umbrella of the Veterans' Administration, the Federal Government has created a method of hearing aid delivery which is costly, ineffective, inefficient in meeting the needs of the hearing-impaired it presumes to serve, all the while directly competing with the preexisting free enterprise system of hearing aid delivery, one which has proven its ability to better serve the hearing-impaired at a much lower cost.

Indeed, due to the fact that the hearing aid specialists in private practice have economic incentive for efficiency and consumer satisfaction, based on competition. Plainly these incentives do not exist in the Veterans' Administration, and other Government-supported systems. Without a doubt, the heaviest price is the price paid by the disabled vet, a man who gave so much to his country to receive so little in return.

I had the pleasure of working on a cost study several years ago and worked very closely with the House Veterans' Affairs Committee through the late Congressman Teague's office, who happened to be a very close personal friend of mine, more like half-brother in fact. I had the opportunity to dig into the cost of dispensing a hearing aid by the Veterans' Administration, and it is ludicrous what it costs you and I taxpayers to deliver a hearing aid to a veteran when he is so inefficiently served. So much for the Veterans' Adminsitration.

Instead of learning from the Veterans' Administration program, it appears that the Federal Government still feels compelled to supplant the free enterprise, small business system of hearing aid delivery with a socialized system of hearing aid delivery. The most recent and rapid growing trend here is for tax-exempt speech and hearing centers to dispense hearing aids. While hiding behind the mask of university and hospitals who receive Government funds, these organizations directly compete with small business. Not on an equal footing, but with numerous unfair advantages, unfair advantages supplied and financed by the Government. While greedily accepting funds taken from your and my tax and charitable contributions, these organizations openly solicit customers away from small business while never paying a single cent in taxes. Why? Under this system I am supporting and subsidizing the very organizations that are going to put me out of business. Is that fair? Is that the principle this republic was founded on 205 years ago?

As I sat here this morning and listended to these gentlemen, Mr. Zerlaut and Mr. Evans in two completely different type of services—we are a service organization—historically made up of mom and pop operations, I cannot believe the similarity that we are experiencing. This thing of Federal funding and grant is going through the threads of our whole small buiness community.

Recently here in the State of California we had an opportunity to help but in a small way cut State funding of a nonprofit organization. We went to the State government and they through the Department of Rehabilitation started deleting certain grants for so-called nonprofit organizations that were paying some of their executives handsome salaries and not paying any taxes and competing against the small businessman. Thank goodness, we had a small success here in California. If these trends continue, it appears that we may well lose one segment of the free enterprise system. In the short term that loss could be glossed over, but in the long run the kind of world it would serve to create could never be glossed over, because in the long run the real losers would not only be the several thousand hearing aid specialists engaged in private enterprise and 20 million Americans suffering from hearing impairment, but every man, woman, and child in this country would suffer.

Yet none of that need ever happen. It can be prevented so easily—not through a Government loan or a tax break or the creation of another new agency, or anything of that nature—simply by removing Government from the marketplace and returning to a truly free enterprise system.

A presentation in more depth will be presented to your committee within the next 2 weeks, sir. I certainly do thank you for the opportunity to permit me to share these thoughts with you this morning, and I can assure you the International Hearing Aid Society supports the companion Senate bill Resolution 93 and the House Resolution 294. Thank you, Senator.

Senator HAYAKAWA. Thank you, Mr. Loupot.

[The prepared statement of Mr. Loupot follows:]

NATIONAL HEARING AID SOCIETY

20361 MIDDLEBELT • LIVONIA MICHIGAN 48152 • TELEPHONE (313) 478-2610

NATIONAL HEADQUARTERS

Executive Vice President
Anthony DiRocco

September 10, 1981

The Honorable S.I. Hayakawa
United States Senate
6217 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Hayakawa:

Thank you again for allowing me the opportunity to address the August 27, 1981 hearing of the Senate Small Business Committee in Los Angeles. Through such hearings concrete evidence of totally unjustified government involvement in, and the resulting unfair competition with the free enterprise system is sure to surface. As I told your Committee in the course of my testimony, we small businesspeople involved in the hearing aid delivery system have had an extensive amount of experience in this area.

Enclosed for your review are several documents which detail the specifics of the key points I raised in my testimony. You will please find the following enclosed:

* Six pieces which detail the inadequacies, inefficiencies and costly nature of the Veterans Administration hearing aid delivery method. These include:
    - An analysis of the General Accounting Office's report "Costs To Operate The Veterans Administration Hearing Aid Program"
    - An article from the April, 1976 issue of HEARING INSTRUMENTS magazine
    - An article from the Spring, 1976 issue of AUDECIBEL magazine
    - An article from the July, 1975 issue of HEARING AID JOURNAL"
    - The National Hearing Aid Society's "Preliminary Analysis of Cost Figures on Hearing Aid Dispensing Provided By the Veterans Administration"
    - Remarks former NHAS President Joseph C. Lucke made to the Veterans Administration on April 18, 1972
* A report entitled "Government Indirectly Finances Unfair Competition in the Hearing Aid Delivery System". This report illustrates how tax-exempt clinics and hospitals are using the government as an unknowing silent partner.

- * *A pre-release of an article by Ms. Marylene Freshley entitled "Small Business Spoke Up --And Was Heard!" This details the efforts of a group of Arizona small businesspeople to get legislative relief from government competition on the state level.*

On behalf of the National Hearing Aid Society and myself, thank you again for focusing national attention upon this vitally important issue. If you require any additional information on government competition with tne free enterprise hearing aid delivery system, please let me know and it will be forwarded to you.

Sincerely yours,

Floyd Loupot

*Floyd Loupot
President*

*FL:pw
enc.
cc: The Honorable David Dreier
House of Representatives*

GOVERNMENT INDIRECTLY FINANCES UNFAIR COMPETITION IN THE HEARING AID DELIVERY SYSTEM

INTRODUCTION

The National Hearing Aid Society (NHAS) is a trade association representing approximately 4,000 hearing aid specialists/dispensers (hearing aid specialists) in the United States and abroad. NHAS was founded thirty years ago to ensure the provision of competent professional assistance at reasonable cost to the twenty million Americans who suffer from hearing impairments. As the principal accrediting body for persons engaged in the testing, selection, fitting, sale and servicing of hearing aids, NHAS administers a demanding Certification program and conducts study courses and seminars to keep its members current on developments in the field.

NHAS and its individual members are committed to working closely and cooperatively with allied members of the hearing health care profession in order to provide the best possible service at the lowest possible cost to the nation's hearing impaired. NHAS is concerned that Revenue Ruling 78-435, 1978-a C.B. 181, which allows the commercial sale of hearing aids by certain tax-exempt organizations, has resulted in unfair competition between different members of the hearing health care delivery team, encouraged the usurpation of traditional functions of one professional group by another, and directly threatened the livelihood of individual members of NHAS.

Revenue Ruling 78-435 held that a tax-exempt organization, whose primary activity is the operation of a hearing clinic providing various rehabilitation services to the hearing impaired, may sell hearing aids to its patients without loss of its exempt status or subjecting the income produced therefrom to taxation as unrelated business income under Section 511 of the Internal Revenue Code. Rev. Rule 78-435, _supra_. The basic rationale of the ruling is that the sale of hearing aids is "an integral part of an organization's program to test and evaluate patients with hearing deficiencies (and) contributes importantly to the organization's purposes of promoting the health of such persons." _Id._

NHAS does not profess to know the specific facts on which Rev. Rule 78-435 was based. NHAS, however, believes that tax-exempt clinics and hospitals have relied upon the revenue ruling to engage in the promotion, marketing and sale of hearing aids in direct and unfair competition with non-exempt hearing aid specialists. Moreover, NHAS believes that, unless modified, Rev. Rul. 78-435 provides a loophole through which such institutions could eliminate the hearing aid specialist and seize control of the sale and dispensation of hearing aids through elimination of the current free enterprise delivery system.

NHAS believes that the purposes for which Rev. Rul. 78-435 was originally issued have been substantially abused by many ostensibly "non-profit" institutions. NHAS believes that many such institutions are now engaged in the sale and dispensation of hearing aids, not merely to provide more comprehensive or convenient services to their traditional patient populations, but rather to penetrate new patient populations and markets traditionally served by hearing aid specialists. NHAS believes that the marketing and promotion of such sales to the general public by such institutions constitute by definition unfair competition and are contrary to the letter, if not the spirit, of the laws and regulations relating to tax-exempt organizations. Accordingly, NHAS believes that an immediate and full investigation of tax-exempt hearing clinics and hospitals engaged in promoting and marketing the sale of hearing aids is necessary. NHAS requests that the exempt status of those organizations which engage in substantial promotional or marketing activities be revoked. Where revocation is not appropriate, NHAS requests that the income derived from such activities be subject to taxation as unrelated business income.

In addition, NHAS believes that Rev. Rul. 78-435 was ill-considered at the time of its issue and should be modified to prevent future instances of abuse and unfair competition. The ruling should be amended to specify that the sale of hearing aids to the outside public or to persons who are "patients" of a tax-exempt institution primarily for the purpose of obtaining a hearing aid does not contribute importantly to the exempt purposes of such institution. Further the ruling should be amended to make clear that such sales may result in the revocation of an organization's exempt status or subject the income derived therefrom to taxation as unrelated business income, (as specified in the Revenue Act of 1950).

THE PROBLEM

The authors of Rev. Rul. 78-435 did not contenplate what in fact has taken place; tax exempt hearing clinics have used their exempt status to enter into direct competition with their non-exempt counterparts. Many such organizations are selling hearing aids, not to provide more comprehensive service to their traditional or regular patients, but to divert and capture a "patient" market they'd previously ignored, one that has been traditionally served by non-exempt hearing aid specialists. Indeed, many such exempt organizations now engage in extensive marketing schemes and promotional activities to penetrate these new markets and to sell hearing aids to the general public. Moreover, the market share diverted or captured by the lure of "low-cost" hearing aids provided by "non-profit" organizations often far exceeds the regular patient populations traditionally served by such organizations. Accordingly, NHAS submits that such sales are generally conducted on a larger scale than reasonably necessary to perform specifically exempted purposes and constitutes unfair competition with non-exempt hearing aid specialists.

While NHAS does not contend that every hospital or hearing clinic engaged in the sale of hearing aids does so for other than charitable purposes, there is growing evidence that many such organizations have exploited Rev. Rul. 78-435 as a means to further capture and control the hearing aid market and to displace the traditional role of the hearing aid specialist as an integral member of the hearing health care delivery team. This goal is clearly a substantial non-exempt purpose which should be considered in examining the exempt status of such organizations.

John Maher, Director of the tax-exempt Northwest Speech and Hearing Clinic (Northwest Clinic) affiliated with the Northwest Hospital in Seattle, Washington, is considered one of the foremost authorities on successfully establishing clinics to sell hearing aids in non-profit settings. He has written several articles and toured the country lecturing on how to develop a profitable hearing aid sales operation within the setting of a tax-exempt organization and to expand the market for the clinic's services. The key to success is, in Mr. Maher's word, marketing.

As a result of Mr. Maher's marketing and promotional techniques, the Northwest Clinic expanded its total patient service from 270 individuals in 1970 to over 9,000 in 1980. Correspondingly, the clinic's gross revenues climbed from $60,000 in 1973-74, with a two-year net operating loss of $26,000 to gross revenues of more than $1 million in 1979, with a net profit of $161,000. In 1970, the clinic employed one-part time audiologist; by 1980, the audiological staff grew to 42.

As a non-profit agency, the Northwest Clinic has also qualified its clinic as a "rehabilitative agency" which entitles it to Medicaid/Medicare records for all area convalescent homes. As a result, Maher today has thousands of beds in convalescent homes under contract for audiological services.

While Maher has marketed and promoted the sale of hearing aids at his tax-exempt clinic as aggressively as any tax-paying hearing aid specialist, he has admitted that his tax status protects and softens the public perception of his marketing strategies.

Non-profit organizations are generally precluded from showing more than a de minimis profit in any taxable year without inviting a skeptical audit by the Internal Revenue Service. That prohibition, however, has not stopped the imaginative Mr. Maher from disguising his profits and retaining the benefits for himself and his organization. Maher has simply plowed the "excess" profits back into salaries.

CONCLUSION

It is apparent from Mr. Maher's own words that the Northwest Clinic, while incorporated as a tax exempt organization, is fundamentally engaged in a profit-making enterprise, the net earnings of which inure to the benefit of Mr. Maher and his audiological staff in the form of salary increases in direct violation of 26 U.S.C. 501 (c) (3). Similarly, the Northwest Clinic has engaged in an aggressive marketing and promotional campaign worthy of its for-profit counterparts in order to sell hearing aids, not to patients referred to the Clinic by the exempt hospital with which it is affiliated, but plainly and simply to the public at large. Indeed the words and statistics provided by Mr. Maher speak for themselves. In short, the Northwest Clinic has been transformed into a major hearing aid retail center, engaging in sales on a scale substantially larger than necessary for the performance of its exempt functions and, in fact, dwarfing the original purposes for which it was ostensibly organized.

NHAS further submits that the Northwest Clinic does not stand alone in its exploitation and abuse of its tax-exempt status. NHAS suggests that there are scores of other such clinics engaging in or contemplating the same kinds of activities.

Finally, NHAS feels that Rev. Rul. 78-435 should be modified to prevent future instances of abuse and unfair competition. It should be amended to specify that the sale of hearing aids to the outside public or to persons who are "patients" of a tax-exempt institution primarily for the purpose of obtaining a hearing aid does not contribute importantly to the exempt purposes of such institution. Further, the ruling should be amended to make clear that such sales may result in the revocation of an organization's exempt status or subject the income derived therefrom to taxation as unrelated business income.

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COSTS TO OPERATE THE VETERANS ADMINISTRATION HEARING AID PROGRAM: REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES -- A NHAS ANALYSIS

There are innumerable discrepancies in the General Accounting Office's report, "Costs To Operate the Veterans Administration Hearing Aid Program", which was released December 4, 1976. Here are a few:

* The Denver VA clinic staff is paid 68 percent more to issue a hearing aid than the Albuquerque VA clinic staff, and the GAO says this is because the Albuquerque clinic is "understaffed."

* The Denver VA clinic staff was paid $16,434.88 to issue 184 hearing aids, exclusive of other salary considerations; and the Albuquerque staff was paid $7,978.50 to issue 150 hearing aids, exclusive of other salary considerations, and the GAO finds neither clinic "overstaffed."

* The Denver audiologists each work an average of 28.8 hours per week, while the Albuquerque audiologist puts in an average of 39.3 hours per week, and the GAO finds this practice to be "reasonable."

* The two Denver audiologists together averaged 4.21 manhours per hearing aid fitting, and the four Denver trainees 4.20 manhours per fitting; and the Albuquerque audiologist averaged 3.23 manhours per fitting, and the two Albuquerque trainees 2.37 manhours per fitting, and the GAO found neither clinic "underutilized."

The General Accounting Office (GAO) began its study in October 1974 at the request of Senator William Proxmire, chairman of the Senate Appropriations Committee's Subcommittee on Housing and Urban Development, and Independent Agencies.

The Senator became interested in the subject after the National Hearing Aid Society's Veterans Administration Committee presented him with some figures provided by the VA that failed to make sense.

After a year's study by the General Accounting Office, the old figures and the new figures still fail to make sense.

Nevertheless, GAO felt assured enough of its research to conclude: "The Veterans Administration program provides for issuing a hearing aid, including all the necessary accessories, to each eligible veteran. The Administration has 45 clinics available to evaluate whether a veteran needs a hearing aid. At the clinics visited it cost an average of $199.90 to provide a hearing aid to a veteran. The costs reviewed appeared reasonable and in GAO's opinion the two Administration clinics visited were neither over-staffed nor underutilized."

The following analysis of the GAO report is based primarily on GAO statistics. However, some additional facts are employed from documents and speeches previously acquired by NHAS. Sources are clearly labeled throughout the text.

This article is a shortened version of the entire NHAS analysis for publication purposes. It deals entirely with an analysis of VA clinic personnel, salaries and workloads. It does not include any study of VA procurement and distribution policies, manufacturers' warranties, hearing aid repairs, and other cost factors besides salaries.

It has been the policy of the NHAS VA Committee to seek only the truth from these figures. Where several interpretations were possible, the fact or figures that would reflect the lowest cost and highest efficiency of the VA hearing aid delivery system was utilized. Such is also the case in the following analysis.

Use of Two VA Clinics in Study

GAO did in-depth studies of VA audiology clinics in Denver and Albuquerque. It then averaged the results of these studies to project an "average" model clinic. Despite wide variations in costs, personnel, time and services, GAO apparently found no discrepancies between the two clinics.

For example, GAO reported that the salary costs attributed to issuing a hearing aid in Denver was $89.32, while the salary cost in Albuquerque was $53.19 -- a difference of $36.13, or a salary cost of 68 percent more in Denver than in Albuquerque.

Despite this wide difference, GAO reported, almost tongue in cheek, "We were informed that this lower salary cost is due to the Albuquerque clinic being understaffed, according to VA staffing criteria, for a clinic its size."

It would seem, therefore, that GAO would be adamant about recommending that the Denver staff be reduced in size to the same level as that in Albuquerque to provide hearing aids to veterans at a substantial salary savings. GAO did not.

FACT: The Denver staff is paid 68% more than the Albuquerque staff to issue a hearing aid.

VA Clinic Workweeks

GAO reported that "about 73 percent of the clinics' staff time is spent providing audiological services to veterans. The remainder (27%) of their time is devoted to training, research, and administrative activities."

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It further reported that "the Denver audiology clinic staff consisted of two audiologists and four audiology trainees. The Albuquerque clinic staff consisted of one audiologist and two trainees. The audiology trainees work 20 hours per week, and their time is divided between working with patients and doing research and class work toward their advanced degrees."

GAO further noted that the Denver clinic provided 2,442 services in 4,205 staff workhours, as compared with an American Speech and Hearing Association standard of 4,144 hours for the same number of services; and the Albuquerque clinic provided 1,275 services in 2,484 hours, compared with an ASHA standard of 2,531 hours. GAO said it found these figures to be "reasonable."

However, in Denver, if the staff worked 4,205 hours providing services, and this represented 73 percent of their work time, they must have worked 5,760 total hours (4,205 ÷ 73%). Since four trainees presumably worked 20 hours per week during the academic year (36 weeks), they must have worked 2,880 of those hours (20 X 36 X 4).

Thus, the two Denver audiologists must have worked only 2,880 hours, or half the total hours worked in the clinic. If two audiologists worked 2,880 hours at 50 weeks a year (assuming 2 weeks vacation), this would average 57.6 hours a week, or 28.8 hours per audiologist.

The Albuquerque figures are better: 2,484 service hours, or 3,403 total hours (2,484 ÷ 73%). The two trainees would have worked 1,440 hours, leaving the lone Albuquerque audiologist 1,963 hours. A 50-week work-year would then average to 39.3 hours per week for the Albuquerque audiologist.

Thus, not only is the Denver clinic's salaries costing 68 percent more to issue a hearing aid than the Albuquerque clinic's salaries, but the Denver audiologists are each working nearly 27 percent fewer hours than the Albuquerque audiologist.

Since this is the standard of the American Speech and Hearing Association, GAO apparently finds nothing remarkable about any of this.

> FACT: The Denver audiologists work an average of 28.8 hours per week; the Albuquerque audiologist works an average of 39.3 hours per week.

Number of Hearing Aids Issued

GAO reported that the Denver clinic issued 184 hearing aids, and the Albuquerque clinic issued 150 aids in fiscal year 1974. Assuming a 50-week work-year, this means that the Denver clinic issued an average of 3.68 aids per week, and the Albuquerque clinic issued 3 aids per week (184 ÷ 50 and 150 ÷ 50). And GAO found that only 24.4 percent of the Denver staff's time was related to issuing a hearing aid, while the Albuquerque staff spend 22.3 percent of its time issuing aids.

However, according to the GAO report: "The VA program provides for issuing a hearing aid, including all the necessary accessories, to each eligible veteran after VA determines that the veteran needs an aid. . . . The veteran, after he has worn his aid for six months, is entitled to a second aid so he will have a spare." (Emphasis supplied.)

If each veteran receives two hearing aids, then the GAO figures for "issuing" a hearing aid must be added together to get a true picture of both clinical manhours and costs required to fit a veteran.

Thus, if the Denver staff spent 24.4 percent of its time issuing 3.68 aids per week, they actually fit only 1.84 veterans (3.68 ÷ 2) during the week. And the Albuquerque staff spent 22.3 percent of its week issuing three hearing aids, but fit only 1.5 veterans (3 ÷ 2).

Therefore, if we double the audiology clinic and central office costs for testing, evaluating, fitting and issuing two hearing aids to a veteran, then add the cost of the hardware, we should be much closer to the actual clinical costs for fitting each veteran. Since, presumably, the testing, evaluating, and fitting are done only once for every two hearing aids issued, averaging costs between two hearing aids is totally misleading.

There is one additional complication, however. In a May 1975 speech, a VA spokesman reported that at that time there were 74,000 VA hearing aids in use, but only 44,000 veterans wearing hearing aids. This means that the number of veterans wearing VA hearing aids is only 59 percent the number of hearing aids issued (44,000 ÷ 74,000).

Assuming these are all monaural fittings (the veteran requires only one hearing aid), we can assume that 30,000 (74,000 - 44,000), or 68 percent (30,000 ÷ 44,000), of the veterans were issued two hearing aids, and 14,000 veterans (44,000 - 30,000), or 32 percent (14,000 ÷ 44,000), had not asked for a spare aid.

On this basis, therefore, we can assume that the 184 hearing aids issued in Denver went to only 111 veterans, 75 of whom (68%) received two hearing aids, and 36 of whom (32%) failed to request a second aid.

Similarly, the Albuquerque clinic presumably fitted their 150 hearing aids on 89 veterans, of whom 61 veterans (68%) received two hearing aids and 28 veterans (32%) failed to ask for a spare.

Therefore, to obtain a true time and cost picture, GAO should have divided clinic costs by the number of veterans fitted since there is relatively little time or cost in providing a veteran with a duplicate hearing aid.

FACT: The Denver clinic fit 111 veterans in Fiscal Year 1974; the Albuquerque clinic fit 89 veterans in FY 1974.

Actual Time Spent by Clinic Staff

As we have seen, the Denver staff spent 4,205 hours providing services to VA patients. Now, if the Denver staff spends only 24.4 percent of its time issuing hearing aids, this means that the staff spent 1,026 hours (4,205 ÷ 24.4%) issuing hearing aids. However, the Denver staff issued its 184 aids to only 111 veterans in FY 1974, for an average of 9.24 staff manhours (1,036 ÷ 111) per fitting.

Since trainees work only 20 hours a week, 36 weeks a year, this amounts to 720 hours (20 X 36) per year. Therefore, the four trainees in Denver contributed 2,880 manhours (720 X 4) to the clinic in 1974. If only 73 percent of their time was devoted to services, they spent 2,102 hours (2,880 X 73%) providing services. If 24.4 percent of this time was related to issuing hearing aids, 512.99 hours (2,102 X 24.4%) were devoted to this activity. If 111 veterans were fitted, the trainees spent 4.62 hours (512.99 ÷ 111) per fitting.

If each fitting required 9.24 staff manhours and the trainees contributed 4.62 hours to the task, the audiologists also spent 4.62 hours per fitting.

Similarly, the Albuquerque staff spent 2, 484 hours providing services. If the Albuquerque staff spends only 22. 3 percent of its time issuing hearing aids, this means the staff spent 553. 93 hours (2, 484 X 22. 3%) issuing hearing aids. However the Albuquerque staff fit only 89 veterans in FY1974, for an average of 6. 22 staff manhours per fitting.

Since trainees work only 20 hours a week, 36 weeks a year, this averages to 720 hours per year. Therefore, the two Albuquerque trainees contributed 1, 440 manhours (720 X 2) to the clinic in 1974. If only 73 percent of their time was devoted to services, they spent 1, 051. 2 (1, 440 X 73%) providing services. If 22. 3 percent of that time was related to issuing hearing aids, 234. 42 hours (1, 051 X 22. 3%) was devoted to this activity. If 89 veterans were fitted, the trainees spent 2. 63 hours per fitting. If each fitting required 6. 22 staff manhours, and the trainees contributed 2. 63 hours to the task, the Albuquerque audiologist spent 3. 59 hours (6. 22 - 2. 63) per fitting.

FACT: The two Denver audiologists together averaged 4. 62 manhours per hearing aid fitting, and the four Denver trainees contributed 4. 62 hours per fitting; the Albuquerque staff audiologist spent 3. 59 hours per fitting, and the two Albuquerque trainees contributed 2. 63 hours. This is a total of 9. 24 manhours per hearing aid fitting in Denver, and 6. 22 manhours in Albuquerque.

Actual Costs Per Fitting

According to the GAO report: "The actual Fiscal Year 1974 salary costs for full-time and trainee positions were identified. To this, a 10-percent factor as computed by VA was added to the full-time salaries for Federal pension and insurance contributions. To this total we applied the sample percentage for audiology time allocated to providing hearing aids and computed an average cost per hearing aid by dividing the number of hearing aids issued into the salary costs applicable to providing hearing aids."

As we have seen, the "cost per aid" figures are misleading. For this reason we set about attempting to determine the actual "cost per fitting."

To do this, we simply took the GAO's Denver salary cost per hearing aid issued, ($89.32), multiplied that by the number of hearing aids issued (184), then divided by the number of fittings (111). Thus, arriving at the Denver salary cost per fitting to be $148.06 ($89.32 X 184 ÷ 111).

We did the same thing with the Albuquerque salary cost and arrived at $89.65 per fitting ($53.19 X 150 ÷ 89).

Assuming that the other clinic cost figures are similarly misrepresented, we followed the same procedure with the other items: travel, equipment depreciation, earmolds, batteries, "other", and central office.

The accompanying chart shows the new computations.

FACT: It costs an average of $295.19 to fit a veteran with a hearing aid in Denver, of which $148.06 is salary costs; and $237.99 to fit a veteran in Albuquerque, of which $89.64 is salary costs; for an average of $266.53 per fitting, of which $118.85 is salary costs.

Clinic Staff Salaries

Now that we have determined that the cost of "fitting a veteran" with a hearing aid is not exactly the same as "issuing a hearing aid," we are ready to compare the cost of the VA hearing aid delivery system with that of the "free enterprise system."

TABLE A

Item	Cost Per Hearing Aid Issued			Cost Per Hearing Aid Fitted		
	Denver Clinic	Albuquerque Clinic	Average Cost	Denver Clinic	Albuquerque Clinic	Average Cost
Supply Service:						
Hearing aid cost	$ 87.96	$ 87.96	$ 87.96	$ 87.96	$ 87.96	$ 87.96
Overhead Charge (14%)	12.31	12.31	12.31	12.31	12.31	12.31
TOTAL	$100.27	$100.27	$100.27	$100.27	$100.27	$100.27
Audiology Clinic:						
Salaries	$ 89.32	$ 53.19*	$ 71.25	$148.06	$ 89.64	$118.85
Travel	11.11	8.64	9.88	18.42	14.56	16.49
Equipment Depreciation	7.31	6.64	6.98	12.12	11.14	11.63
Ear Molds	4.08	5.74	4.91	6.76	9.67	8.22
Batteries	1.02	1.02	1.02	1.69	1.72	1.71
Other	.87	2.65	1.76	1.44	4.47	2.96
TOTAL	$113.71	$ 77.88	$ 95.80	$188.49	$131.26	$159.86
Central Office	$ 3.83	$ 3.83	$ 3.83	$ 6.34	$ 6.46	$ 6.40
TOTAL COST	$217.81	$181.98	$199.90	$295.19	$237.99	$266.53

*We were informed that this lower salary cost is due to the Albuquerque clinic being understaffed, according to VA staffing criteria, for a clinic its size.

In developing the above costs, we reviewed cost records and other documents and did not find any costs which appeared unreasonable.

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Before we do that, however, there is one interesting sidelight that should be explored, and that is the staff salaries of the VA clinics. The reason this is important is that the VA system has been seen as the "model" system for delivering hearing aids for many years. It has been seen to be the least expensive, most efficient, most patient-oriented system possible.

But is it?

In a November 1974 letter, a VA spokesman reported that the average VA audiologist earned a salary of $19, 078, and the average trainee $4, 660. We also know that the GAO added "a 10-percent factor" to the full-time (audiologists') salaries for "federal pension and insurance contributions" when computing salaries for hearing aid delivery costs.

Thus, GAO probably rated the audiologists at about $20, 985. 80 ($19, 078 + 10%), and rated the trainees at about $4, 660.

Although federal employees have received substantial raises and cost of living increases since 1974, we can assume that both audiologists and trainees have received substantially the same rates of increase and that, therefore, the ratio of pay between audiologists and trainees has remained about the same. In other words, we are assuming that trainees are paid at about 22 percent the salaries of the audiologists ($4, 660 ÷ $20, 985. 80).

On this basis, the Denver clinic salaries could be broken down into two audiologists (2a) and four trainees (4 X . 22a), or a combined 2. 88a, in which "a" represents the audiologists' rate of pay, and ". 22a" represents each trainee's pay. Albuquerque clinic salaries could be broken down into one audiologists' pay (a) and two trainees' (2 X . 22a), or a combined 1. 44a.

Employing GAO's figures, we know that it costs $89.32 in salaries to "issue" a hearing aid in Denver. Divided by 2.88, this breaks down to a cost of $31.01 ($89.32 ÷ 2.88) for each audiologist, or a total of $62.02 ($31.01 X 2) in audiological time, and $6.83 ($31.01 X .22) for each trainee, or $27.30 ($6.83 X 4) for trainee time for each hearing aid.

We also know that there are 3.68 hearing aids issued per week. Therefore, each audiologist is paid $114.12 ($31.01 X 3.68) a week for his hearing aid issuing duties.

We also know that these duties require only 24.4 percent of his services time. So, if we divide $114.12 by 24.4 percent, we learn that each audiologist is paid $467.70 a week for services. But this is only 73 percent of his time, so we must divide this figure again by 73% to find that each Denver audiologist is paid $640.68 a week. Since each full-time audiologist is paid 52 weeks a year, we discover that each Denver audiologist, according to GAO figures, is paid $33,315.36 annually! And each Denver trainee is paid $5,079.94 for 36 weeks!

Employing the same technique with the Albuquerque figures, we discover that the $53.19 salary cost for issuing a hearing aid breaks down to $36.94 for the audiologist and $16.25 for both trainees, or $8.13 each.

The Albuquerque clinic issues an average of three hearing aids a week. Therefore, the audiologist is paid $110.82 ($36.94 X 3) a week for his hearing aid issuing duties. Since this represents only 22.3 percent of his time, we divide $110.82 by 22.3 percent to learn that the audiologist is paid $496.95 a week for his services. Since this represents only 73 percent of his time, we again divide this figure by 73 percent to find that the Albuquerque audiologist is paid $680.75 a week. Therefore, at 52 weeks a year, the Albuquerque audiologist, according to GAO figures, is paid $35,399 annually! And the Albuquerque trainees are each paid $5,162.21 annually (36 weeks).

VA vs. Free Enterprise System

NHAS feels that there are enough discrepancies in the GAO report to make any justifiable comparison between the Veterans Administration and the free enterprise delivery systems impossible.

Nevertheless, GAO attempts to compare "contract price for purchase from manufacturer" with "contract price for purchase from local dealer" for some 28 different models of hearing aids. This is somewhat ludicrous because the manufacturer's price is at wholesale, while the dealer's prices are at retail. See Table B.

However, despite GAO's inability to recognize this factor, the dealer prices do give an indication of the prices VA must pay if the veteran insists that he wants his hearing aid fitted by a local dealer.

The average contract price for purchase from a local dealer is $264.49! As we have determined, the average VA delivery price through a clinic is $266.53!

But let's for a moment consider how these costs are distributed.

A NHAS member whodoes some VA business provided an analysis of his pricing structure. This dealer does a volume business in a representative area of the country, covering both rural and metropolitan areas. He maintains several offices, with several hearing aid specialists in the field. And, most important of all, he is computerized so that he knows within 1/100th of a percentage point where his costs lie.

A summary of his price breakdown applied to the GAO's reported "local dealer cost" is compared with the VA clinic costs per fitting as derived by NHAS from GAO figures. See Table C.

TABLE [illegible]

VA CONTRACT PRICES FOR HEARING AID PURCHASES
OCTOBER 1, 1973, TO SEPTEMBER 30, 1974

Model (note a)	Contract Price for Purchase from Manufacturer	Contract Price for Purchase from Local Dealer
1	$ 97.50	$291.75
2	90.75	299.25
3	105.00	266.00
4	105.00	266.00
5	131.05	242.14
6	94.50	296.50
7	99.00	188.00
8	85.00	170.00
9	145.00	263.00
10	82.00	315.20
11	71.50	268.75
12	97.50	287.60
13	86.60	227.15
14	129.60	307.60
15	116.10	276.15
16	126.00	293.65
17	95.00	202.00
18	119.00	289.00
19	129.00	299.00
20	109.00	275.00
21	149.00	297.00
22	159.00	310.00
23	94.00	264.00
24	96.00	243.06
25	96.00	235.11
26	81.50	230.22
27	75.00	219.82
28	72.20	282.72
Average (note b)	104.88	264.49

a/Descriptions of hearing aids from both sources are essentially the same except that the aids from dealers include batteries.

b/This is the average cost of all models available for purchase during the contract year.

TABLE C

Item	VA COST PER FITTING		DEALER COST PER FITTING	
	VA Cost	VA Percentage	Dealer Cost	Dealer Percentage
Supply Service:				
Hearing Aid Cost	$ 87.96	33.00	$ 92.57	35.00
Ear Molds	8.22	3.08	0.21	0.08
Batteries	1.71	0.64	0.19	0.07
Overhead charge	12.31	4.62	0.00	0.00*
TOTAL	$110.20	41.34	$ 92.97	35.15
Operating Costs:				
Salaries	$118.85	44.59	$ 95.22	36.00
Pension	--	--	7.93	3.00
Health	--	--	8.60	3.25
Personnel Taxes (Social Security Workmen's Comp. Unemployment etc.)	--	--	5.03	1.90
Travel	16.49	6.19	4.76	1.80
Depreciation	11.63	4.36	10.58	4.00
Other	2.96	1.12	--	--
Outside Profes. Help	--	--	0.07	0.03
Education	--	--	0.32	0.12
Advertising	--	--	9.52	3.60
Promotion	--	--	0.26	0.10
Dues & Subscriptions	--	--	0.19	0.07
Interest	--	--	7.54	2.85
Postage	--	--	4.44	1.68
Rent	--	--	0.26	0.10**
Equip. Repair & Maint.	--	--	0.39	0.15
Office Supplies	--	--	3.17	1.20
Telephone	--	--	5.82	2.20
Utilities	--	--	2.25	0.85
Pers. Property Tax	--	--	1.98	0.75
Contracted Services	--	--	0.32	0.12
TOTAL	$149.93	56.26	$168.65	63.77
Central Office	$ 6.40	2.40	$ 1.59	0.60
Profit	--	--	$ 1.27	0.48
TOTALS	$266.53	100.00	$264.48	100.00

*This dealer custom orders each hearing aid and therefore has no inventory.

**This dealer owns his own offices.

FACT: The hearing aid dealer pays slightly more for a hearing aid at wholesale than the VA, but his supply section costs are less because he "custom orders" his hearing aids and earmolds and has little or no inventory.

FACT: Hearing aid dealership personnel receive about the same percentage in salaries and fringe benefits as VA personnel per hearing aid fitting.

FACT: Dealer travel costs are about one-fourth the VA travel costs.

FACT: A typical dealer attributes about the same percentage to depreciation as the VA.

FACT: A dealer pays nearly 14 percent of each fitting cost in outside professional services, education, advertising, promotion, dues and subscriptions, interest, postage, rent, equipment repair and maintenance, office supplies, telephone, utilities, personal property taxes and contracted services. The VA apparently pays only 1.12 percent for these "other costs."

FACT: A dealer attributes about 0.6 percent of a fitting cost to administration; the VA attributes about 2.4 percent.

FACT: An efficient hearing aid dealer makes about 0.48 percent profit on each fitting; the Veterans Administration makes no profit.

FACT: The hearing aid dealer:

A. Employs people at no cost to the taxpayers.

B. Provides medical care and pensions for himself and his staff at no cost to the taxpayers.

C. Delivers services to the veteran's door at about one-third the cost that the VA pays the veteran to travel to a clinic, and does it at no cost to the taxpayers.

D. Pays all business expenses at no cost to the taxpayer.

E. Pays a substantial amount of direct and indirect taxes to local, state and federal governments at no cost to the taxpayer.

F. Makes about 0.48 percent profit on each fitting at no cost to the taxpayer.

G. Provides all after-fitting counseling and services to the veteran without charge at no cost to the taxpayer.

FACT: The General Accounting Office concluded: "At the clinics visited it cost an average of $109.90 to provide a hearing aid to a veteran. The costs reviewed appeared reasonable and in GAO's opinion the two Administration clinics visited were neither overstaffed or underutilized."

Observations

In light of this NHAS analysis of the GAO report, it is apparent that something is wrong with the government cost accounting system.

Somehow, it is not enough to lump under a category of "other" such costs as outside professional services, education, dues and subscriptions, postage, rent, equipment repair and maintenance, office supplies, telephone and utilities. This "lumping" should particularly not take place when comparisons between clinic and free enterprise systems are being made.

Further, it is patently misleading to compare the VA's wholesale purchase price from hearing aid manufacturers with its purchase price at retail from a hearing aid dealer.

More importantly, it is totally misleading to use the "cost of hearing aids issued" when most veterans receive two hearing aids and clinic costs are "averaged" between the two. It is particularly misleading when the clinic half-costs are compared with dealer full-costs.

And if the VA system is so patient-oriented, why do one-third of the veterans fitted with VA hearing aids fail to request a spare hearing aid?

And so, if the GAO really did a conscientious study of the VA hearing aid delivery system, how could it call a 68 percent difference between salary costs in Albuquerque and those in Denver "reasonable," and excuse the difference with the comment, "We were informed that this lower salary costs is due to the Albuquerque clinic being understaffed, according to VA staffing criteria, for a clinic its size."?

How could GAO ignore the fact that Denver audiologists [illegible] working "full-time" for only 28.8 hours a week?

And why does it take some 9.24 staff manhours to fit a hearing aid in Denver, and 6.22 manhours in Albuquerque?

And how could GAO justify salaries for VA clinic audiologists more than 50 percent higher than VA spokesmen say audiologists are paid?

Finally, if the VA audiologists are being paid so handsomely for so little work, what else are they doing? Are tests, evaluations and fittings actually being done by trainees without audiologist supervision? If so, what are the audiologists doing? Are any of these audiologists engaged in other pursuits? If so, what other pursuits, and why?

Why?

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Viewpoint

THE OTHER SIDE OF THE COIN

A National Hearing Aid Society Analysis of "Costs to Operate the Veterans Administration Hearing Aid Program: Report of the Comptroller General of the United States."

Editor's Note: The following article, prepared by the National Hearing Aid Society staff, summarizes the NHAS analysis of the costs of hearing aid distribution through the VA system. Copies of the report of the Comptroller General of the United States—B-182457—are available from: Elmer B. Staats, U.S. Comptroller General, Government Accounting Office, Washington, D.C. 20548.

■ The General Accounting Office (GAO) began its study in October 1974 at the request of Senator William Proxmire (D-Wisc.), chairman of the Senate Appropriations Committee's Subcommittee on Housing and Urban Development, and Independent Agencies. The Senator became interested in the subject after the National Hearing Aid Society's Veterans Administration Committee presented him with some figures provided by the VA that failed to make sense. After a year's study by the GAO, the old figures provided by the VA and the new figures provided by GAO still fail to make sense. Nevertheless, GAO felt assured enough of its research to conclude: "The Veterans Administration program provides for issuing a hearing aid, including all the necessary accessories, to each eligible veteran. The Administration has 45 clinics available to evaluate whether a veteran needs a hearing aid. At the clinics visited it cost an average of $199.90 to provide a hearing aid to a veteran. The costs reviewed appeared reasonable and in GAO's opinion, the two Administration clinics visited were neither overstaffed nor underutilized."

The following analysis shows that the figure of $199.90 is grossly inaccurate.

The data presented here is based primarily on GAO statistics. However, some additional facts are employed from documents and speeches previously acquired by NHAS. Sources are clearly labeled throughout the text.

This article, a shortened version of the complete NHAS analysis, deals entirely with an analysis of VA clinic personnel, salaries and workloads. It does not include any study of VA procurement and distribution policies, manufacturers' warranties, hearing aid repairs or other cost factors besides salaries.

It has been the policy of the NHAS VA Committee to seek only the truth from these figures. Where several interpretations were possible, the fact or figures that would reflect the lowest cost and highest efficiency of the VA hearing aid delivery system was utilized. Such is also the case in the following analysis.

Use of Two VA Clinics in Study

FACT: The Denver staff is paid 68% more than the Albuquerque staff to issue a hearing aid.

GAO did in-depth studies of VA audiology clinics in Denver and Albuquerque. It then averaged the results of these studies to project an "average" model clinic. Despite wide variations in costs, personnel, time and services, GAO apparently found no discrepancies between the two clinics and did not indicate whether these were typical of VA clinic costs.

For example, GAO reported that the salary costs attributed to issuing a hearing aid in Denver was $49.32, while the salary cost in Albuquerque was $33.19—a difference of $16.13, or a salary cost of 68 percent more in Denver than in Albuquerque. Despite this wide difference, GAO reported, "We were informed that this lower salary cost is due to the Albuquerque clinic being understaffed, according to VA staffing criteria, for a clinic its size." It would seem therefore, that GAO would have recommended that the Denver staff be reduced in size to the same level as that in Albuquerque to provide hearing aids to veterans at a substantial salary savings. GAO did not.

VA Clinic Workweeks

FACT: Denver audiologists work an average of 28.8 hours per week; the Albuquerque audiologist works an average 39.3 hours per week.

GAO reported that "about 73 percent of the clinics' staff time is spent providing audiological services to veterans. The remainder (27%) of their time is devoted to training, research, and administrative activities." It further reported that "the Denver audiology clinic staff consisted of two audiologists and four audiology trainees. The Albuquerque clinic staff consisted of one audiologist and two trainees. The audiology trainees work 20 hours per week, and their time is divided between working with patients and doing research and class work toward their advanced degrees."

GAO further noted that the Denver clinic provided 2442 services in 4205 staff workhours, as compared with an American Speech and Hearing standard of 4144 hours for the same number of services; and the Albuquerque clinic provided 1275 services in 2484 hours, compared with an ASHA standard of 2531 hours. GAO said it found these figures to be "reasonable."

However, in Denver, if the staff worked 4205 hours providing services, and this represented 73 percent of their work time, they must have worked 5760 total hours (4205 ÷ 73%). Since four trainees presumably worked 20 hours per week during the academic year (36 weeks), they must have worked 2880 of those hours (20 × 36 × 4).

Thus, the two Denver clinical audiologists must have worked only 2880 hours (5760 − 2880) or half the total hours worked in the clinic. If two clinical audiologists worked 2880 hours at 50 weeks a year (assuming 2 weeks vacation), this would average 57.6 hours a week, or 28.8 hours per clinical audiologist.

The Albuquerque figures are better: 2484 service hours, or 3403 total hours (2484 ÷ 73%). The two trainees would have worked 1440 hours, leaving the lone Albuquerque clinical audiologist 1963 hours (3403 − 1440). A 50-week work-year would then average to 39.3 hours per week for the Albuquerque clinical audiologist.

Thus, not only are the Denver clinic's salaries costing 68 percent more to issue a hearing aid than the Albuquerque clinic's salaries, but the Denver clinical audiologists are each working nearly 27 percent (10.5 ÷ 39.3%) less hours than the Albuquerque clinical audiologist.

Yet, GAO apparently finds nothing particularly remarkable about any of this, even though there is a serious disparity between the two.

Number of Hearing Aids Issued

FACT: The Denver clinic fit 111 veterans in Fiscal Year 1974; the Albuquerque clinic fit 89 veterans in FY 1974.

GAO reported that the Denver clinic issued 184 hearing aids and the Albuquerque clinic issued 150 aids in Fiscal Year 1974. Assuming a 50-week work-year, this means that the Denver clinic issued an average of 3.68 aids per week, and the Albuquerque clinic issued 3 aids per week (184 ÷ 50 and 150 ÷ 50). GAO found that only 24.4 percent of the Denver staff's time was related to issuing a hearing aid, while the Albuquerque staff spent only 22.3 percent of its time issuing aids.

However, according to the GAO report: "The VA program provides for issuing a hearing aid, including all the necessary accessories, to each eligible veteran after VA determines that the veteran needs an aid . . . . **The veteran, after he has worn his aid for six months, is entitled to a second aid so he will have a spare.**" (Emphasis supplied.)

If each veteran receives two hearing aids, then the GAO figures for "issuing" a hearing aid must be added together to get a true picture of both clinical manhours and costs required to fit a veteran.

Thus, if the Denver staff spent 24.4 percent of its time issuing 3.68 aids per week, they actually fit only 1.84 veterans (3.68 ÷ 2) during that time. The Albuquerque staff, which spent 22.3 percent of its week issuing three hearing aids, fit only 1.5 veterans (3 ÷ 2).

Therefore, if we double the audiology clinic and central office costs for testing, evaluating, fitting and issuing two hearing aids to a veteran, then add the cost of the hardware, we should be much closer to the actual clinical costs for fitting each veteran. Since, presumably, the testing, evaluating, and fitting are done only once for every two hearing aids issued, averaging costs between two hearing aids is totalling misleading.

There is one additional complication, however. In a May 1975 speech, a VA spokesman reported that at that time there were 74,000 VA hearing aids in use, but only 44,000 veterans wearing hearing aids. This means that the number of veterans wearing VA hearing aids is only 59 percent of the number of hearing aids issued (44,000 ÷ 74,000).

Assuming these are all monaural fittings (the veteran requires only one hearing aid), we can assume that 30,000 (74,000 — 44,000), or 68 percent (30,000 ÷ 44,000), of the veterans were issued two hearing aids, and 14,000 veterans (44,000 — 30,000), or 32 percent (14,000 ÷ 44,000), had not asked for a spare aid.

On this basis, therefore, we can assume that the 184 hearing aids issued in Denver went to only 111 veterans (184 × 59%), 75 of whom (68%) received two hearing aids, and 36 of whom (32%) failed to request a second aid.

Similarly, the Albuquerque clinic presumably fitted their 150 hearing aids on 89 veterans (150 × 59%), of whom 61 veterans (68%) received two hearing aids and 28 veterans (32%) failed to ask for a spare. Therefore, to obtain a true time and cost picture, GAO should have divided clinic costs by the number of veterans fitted since there is relatively little time or cost in providing a veteran with a duplicate hearing aid.

Actual Time Spent by Clinic Staff

FACT: The two Denver clinical audiologists together averaged 4.62 manhours per hearing aid fitting, and the four Denver trainees contributed 4.62 hours per fitting; the Albuquerque staff clinical audiologist spent 3.59 hours per fitting, and the two Albuquerque trainees contributed 2.63 hours. This is a total of 9.24 manhours per hearing aid fitting in Denver, and 6.22 manhours in Albuquerque.

As we have seen, the Denver staff spent 4205 hours providing services to VA patients. Now, if the Denver staff spends only 24.4 percent of its time issuing hearing aids, this means that the staff spent 1026 hours (4205 × 24.4%) issuing hearing aids. However, the Denver staff issued its 184 aids to only 111 veterans in FY 1974, for an average of 9.24 staff manhours (1036 ÷ 111) per fitting.

Since trainees work only 20 hours a week, 36 weeks a year, this amounts to 720 hours (20 × 36) per year. Therefore, the four trainees in Denver contributed 2880 manhours (720 × 4) to the clinic in 1974. If only 73 percent of their time was devoted to services, they spent 2102 hours (2880 × 73%) providing services. If 24.4 percent of this time was related to issuing hearing aids, 512.99 hours (2102 × 24.4%) were devoted to this activity. If 111 veterans were fitted, the trainees spent 4.62 hours (512.99 ÷ 111) per fitting. If each fitting required 9.24 staff manhours and the trainees contributed 4.62 hours to the task, the clinical audiologists also spent 4.62 hours per fitting.

Similarly, the Albuquerque staff spent 2484 hours providing services. If the Albuquerque staff spends only 22.3 percent of its time issuing hearing aids, this means the staff spent 553.93 hours (2484 × 22.3%) issuing hearing aids. However, the Albuquerque staff fit only 89 veterans in FY 1974, for an average of 6.22 staff manhours per fitting. Since trainees work only 20 hours a week, 36 weeks a year, this averages to 720 hours per year. Therefore, the two Albuquerque trainees contributed 1440 manhours (720 × 2) to the clinic in 1974. If only 73 percent of their time was devoted to services, they spent 1051.2 (1440 × 73%) providing services. If 22.3 percent of that time was related to issuing hearing aids, 234.42 hours (1051 × 22.3%) was devoted to this activity. If 89 veterans were fitted, the trainees spent 2.63 hours per fitting. If each fitting required 6.22 staff manhours, and the trainees contributed 2.63 hours to the task, the Albuquerque clinic audiologist spent 3.59 hours (6.22 — 2.63) per fitting.

Actual Costs Per Fitting

FACT: It costs an average of $295.19 to fit a veteran with a hearing aid in Denver, of which $148.06 is salary costs; and $237.99 to fit a veteran in Albuquerque, of which $89.64 is salary costs; for an average of $266.53 per fitting, of which $118.85 is salary costs.

According to the GAO report: "The actual Fiscal Year 1974 salary costs for full-time and trainee positions were identified. To this, a 10-percent factor as computed by VA was added to the full-time salaries for Federal pension and insurance contributions. To this total, we applied the sample percentage for audiology time allocated to providing hearing aids and computed an average cost per hearing aid by dividing the number of hearing aids issued into the salary costs applicable to providing hearing aids."

Since the "cost per aid" figures are misleading, we set about attempting to determine the actual "cost per fitting." To do this, we simply took the GAO's Denver salary cost per hearing aid issued, (89.32), multiplied that by the number of hearing aids issued (184), then divided by the number of fittings (111). Thus we determined that the Denver salary cost alone per fitting is $148.06 ($89.32 × 184 ÷ 111).

We did the same thing with the Albuquerque salary cost and arrived at $89.65 per fitting ($53.19 × 150 ÷ 89).

Assuming that the other clinic cost figures are similarly misrepresented, we followed the same procedure with the other items: travel, equipment depreciation, earmolds, batteries, "other", and central office. Table A shows the new computations.

Clinic Staff Salaries

FACT: The average annual salary and fringe benefits for the two Denver audiologists are $33,315.36 each, and the average Denver trainee is paid $5079.94; the Albuquerque clinical audiologist is paid $35,399 annually, including fringe benefits, and the trainees $5162.21. However, VA reported in November 1974 that the average clinical audiologist earned about $20,985.80 and the average trainee $4660.

Now that we have determined that the cost of "fitting a veteran" with a hearing aid is not exactly the same as "issuing a hearing aid," we are ready to compare the cost of the VA hearing aid delivery system with that of the "free enterprise system."

Before we do that, however, there is one interesting sidelight that should be explored and that is the staff salaries of the VA clinics. This is important because the VA system has been seen as the "model" system for delivering hearing aids. It has been seen to be the least expensive, most efficient, most patient-oriented system possible. But is it?

In a November 1974 letter, a VA spokesman reported that the average VA clinical audiologist earned a salary of $19,078, and the average trainee $4660. We also know that the GAO added "a 10-percent factor" to the full-time (clinical audiologists') salaries for "federal pension and insurance contributions" when computing salaries for hearing aid delivery costs.

TABLE A

Item	Cost Per Hearing Aid Issued: Denver Clinic	Cost Per Hearing Aid Issued: Albuquerque Clinic	Cost Per Hearing Aid Issued: Average Cost	Cost Per Hearing Aid Fitted: Denver Clinic	Cost Per Hearing Aid Fitted: Albuquerque Clinic	Cost Per Hearing Aid Fitted: Average Cost
Supply Service:						
Hearing aid cost	$ 87.96	$ 87.96	$ 87.96	$ 87.96	$ 87.96	$ 87.96
Overhead Charge (14%)	12.31	12.31	12.31	12.31	12.31	12.31
TOTAL	$100.27	$100.27	$100.27	$100.27	$100.27	$100.27
Audiology Clinic:						
Salaries	$ 89.32	$ 53.19*	$ 71.25	$148.06	$ 89.64	$118.85
Travel	11.11	8.64	9.88	18.42	14.56	16.49
Equipment Depreciation	7.31	6.54	6.98	12.12	11.14	11.63
Ear Molds	4.08	5.74	4.91	6.76	9.67	8.22
Batteries	1.02	1.02	1.02	1.69	1.72	1.71
Other	.87	2.65	1.76	1.44	4.47	2.96
TOTAL	$113.71	$ 77.88	$ 95.80	$188.49	$131.26	$159.86
Central Office	$ 3.83	$ 3.83	$ 3.83	$ 6.34	$ 6.46	$ 6.40
TOTAL COST	$217.81	$181.98	$199.90	$295.19	$237.99	$266.53

*We were informed that this lower salary cost is due to the Albuquerque clinic being understaffed, according to VA staffing criteria for a clinic its size.

In developing the above costs, we reviewed cost records and other documents and did not find any costs which appeared unreasonable.

Thus, GAO probably rated the clinical audiologists at about $20,985.80 ($19,078 + 10%) and rated the trainees at about $4660.

Although federal employees have received substantial raises and cost of living increases since 1974, we can assume that both clinical audiologists and trainees have received substantially the same rates of increase and that, therefore, the ratio of pay between clinical audiologists and trainees has remained about the same. In other words, we are assuming that trainees are paid at about 22 percent the salaries of the clinical audiologists ($4660 ÷ $20,985.80).

On this basis, the Denver clinic salaries could be broken down into two clinical audiologists (2a) and four trainees (4 × .22a), or a combined 2.88a, in which "a" represents the audiologists' rate of pay and ".22a" represents each trainee's pay. Albuquerque clinic salaries could be broken down into one clinical audiologists' pay (a) and two trainees' (2 × .22a), or a combined 1.44 a.

Employing GAO's figures, we know that it costs $89.32 in salaries to "issue" a hearing aid in Denver. Divided by 2.88, this breaks down to a cost of $31.01 ($89.32 ÷ 2.88) for each clinical audiologist, or a total of $62.02 ($31.01 × 2) in audiological time, and $6.83 ($31.01 × .22) for each trainee, or $27.30 ($6.83 × 4) for trainee time for each hearing aid.

We also know that there are 3.68 hearing aids issued per week. Therefore, each clinical audiologist is paid $114.12 ($31.01 × 3.68) a week for his hearing aid issuing duties.

We also know that these duties require only 24.4 percent of his services time. So, if we divide $114.12 by 24.4 percent, we learn that each clinical audiologist is paid $467.70 a week for services. But this is only 73 percent of his time, so we must divide this figure again by 73% to find that each Denver clinical audiologist is paid $640.68 a week. Since each full-time clinical audiologist is paid 52 weeks a year, we can assume that each Denver clinical audiologist, according to GAO figures, is paid $33,315.36 annually! And each Denver trainee is paid $5079.94 for 36 weeks!

Employing the same technique with the Albuquerque figures, we discover that the $53.19 salary cost for issuing a hearing aid breaks down to $36.94 for the clinical audiologist and $16.25 for both trainees, or $8.13 each.

The Albuquerque clinic issues an average of three hearing aids a week. Therefore, the clinical audiologist is paid $110.82 ($36.94 × 3) a week for his hearing aid issuing duties. Since this represents only 22.3 percent of his time, we divide $110.82 by 22.3 percent to learn that the clinical audiologist is paid $496.95 a week for his services. Since this represents only 73 percent of his time, we again divide this figure by 73 percent to find that the Albuquerque clinical audiologist is paid $680.75 a week. Therefore, at 52 weeks a year, the Albuquerque clinical audiologist, according to GAO figures, is paid $35,399 annually! And the Albuquerque trainees are each paid $5162.21 annually (36 weeks).

VA vs. Free Enterprise System

FACT: GAO compares the VA wholesale purchase price from manufacturers without value-added clinic service costs, to the VA retail purchase price from dealers, including the value-added dealer service costs and concludes that the VA wholesale procurement price is less expensive.

NHAS feels that there are enough discrepancies in the GAO report to make any justifiable comparison between the Veterans Administration and the free enterprise delivery systems impossible.

Nevertheless, GAO attempts to compare "contract price for purchase from manufacturer" with "contract price for purchase from local dealer" for some 28 different models of hearing aids. This is somewhat ludicrous because the manufacturer's price is quoted at less than wholesale for hardware alone, while the dealer's prices include a range of services. See Table B.

TABLE B
VA CONTRACT PRICES FOR HEARING AID PURCHASES—OCTOBER 1, 1973, TO SEPTEMBER 30, 1974

Model (note a)	Contract Price for Purchase from Manufacturer	Contract Price for Purchase from Local Dealer
1	$ 97.50	$291.75
2	90.75	299.25
3	105.00	260.00
4	105.00	266.00
5	131.05	242.14
6	94.50	296.50
7	99.00	188.00
8	85.00	170.00
9	145.00	263.00
10	82.00	315.20
11	71.50	268.75
12	97.50	287.60
13	86.60	227.15
14	129.60	307.60
15	116.10	276.15
16	126.00	293.65
17	95.00	202.00
18	119.00	289.00
19	129.00	299.00
20	109.00	275.00
21	149.00	297.00
22	159.00	310.00
23	94.00	264.00
24	96.00	243.06
25	96.00	225.11
26	81.50	230.22
27	75.00	219.82
28	72.20	282.72
Average (note b)	104.88 (note c)	264.49 (note d)

a/Descriptions of hearing aids from both sources are essentially the same except that the aids from dealers include batteries.

b/This is the average cost of all models available for purchase during the contract year.

c/This is the price for hearing aids delivered to the Hines Supply Depot and does not include the costs of any services.

d/If a hearing aid is purchased from a hearing aid specialist, in addition to demonstrating the aid, the hearing aid specialist assists in selecting and fitting the aid and advises the patient as to its care and maintenance, and counsels the patient to assist in his adjustment to hearing aid usage.

However, despite GAO's inability to recognize this factor, the dealer prices do give an indication of the prices VA must pay if the veteran insists that he wants his hearing aid fitted by a local dealer. The average contract price for purchase from a local dealer is $264.49! And, as we have determined, the average VA clinic delivery price is $266.53! We also do not know if that price provides as much service as the dealer provides.

But let's for a moment consider how these costs are distributed.

A NHAS member who does some VA business provided an analysis of his pricing structure. This hearing aid specialist does a volume business in a representative area of the country, covering both rural and metropolitan areas. He maintains several offices, with several hearing aid specialists in the field. And, most important of all, he is computerized so that he knows within 1/100th of a percentage point where his costs lie.

A summary of his price breakdown applied to the GAO's reported "local dealer cost" is compared with the VA clinic costs per fitting as derived by NHAS from GAO figures. See Table C.

This comparison illustrates the many "costs" that hearing aid specialists must consider in their overall operating budgets, while at the same time graphically detailing the areas in which the Veterans Administration avoids costs (advertising, promotion, interest) or where GAO "did not attempt to allocate hospital costs for administrative support services to the hearing aid program since the audiology clinics were such a small part of the total hospital operation" (postage, rent, equipment repair, telephone, utilities, etc.).

Our analysis shows that this volume hearing aid specialist pays slightly more for a hearing aid at wholesale than the VA, but his supply service costs are less because he "special orders" his hearing aids and thus has little or no inventory. He also makes his own earmolds for each hearing aid fitting and includes their cost of the hearing aid. Batteries are treated as a separate category, not applicable here.

Hearing aid dealership personnel also receive about the same percentage of each fitting cost in salaries and fringe benefits as VA personnel receive per hearing aid fitting. These personnel costs, however, include **all** personnel—receptionists, secretaries, technicians, hearing aid specialists and the dealer himself. The VA salary figures include only clinical audiologists and trainees. GAO, presumably, considered secretaries, clerks, etc., to be administrative support personnel who played no role in the issuing of a hearing aid.

It's interesting that a hearing aid specialist's travel costs are less than one-third the travel costs per fitting of the VA. "Eligible veterans required to travel to a VA hospital for treatment are entitled to be reimbursed for travel costs," the GAO report explains. "As of June 30, 1975, veterans were being reimbursed for mileage at the rate of 8 cents per mile. A review of travel reimbursements paid to veterans seen at the audiology clinics visited did not reveal any instances where an overnight stay was involved."

In other words, it costs VA about $16.49 to bring a veteran to a VA clinic for a fitting and return him home. This figure, of course, does not include the veteran's out-of-pocket costs, such as

TABLE C

Item	VA COST PER FITTING VA Cost	 VA Percentage	DEALER COST PER FITTING Dealer Cost	 Dealer Percentage
Supply Service:				
Hearing Aid Cost	$ 87.96	33.00	$ 92.97	35.15
Ear Molds	8.22	3.08	0.00	0.00
Batteries	1.71	0.64	0.00	0.00
Overhead charge	12.31	4.62	0.00	0.00*
TOTAL	$110.20	41.34	$ 92.97	35.15
Operating Costs:				
Salaries	$118.85	44.59	$ 95.22	36.00
Pension	—	—	7.93	3.00
Health	—	—	8.60	3.25
Personnel Taxes (Social Sec., etc.)	—	—	5.03	1.90
Travel	16.49	6.19	4.76	1.80
Depreciation	11.63	4.36	10.58	4.00
Other	2.96	1.12	—	—
Outside Profes. Help	—	—	0.07	0.03
Education	—	—	0.32	0.12
Advertising	—	—	9.52	3.60
Promotion	—	—	0.26	0.10
Dues & Subscriptions	—	—	0.19	0.07
Interest	—	—	7.54	2.85
Postage	—	—	4.44	1.68
Rent	—	—	0.26	0.10**
Equip. Repair & Maint.	—	—	0.39	0.15
Office Supplies	—	—	3.17	1.20
Telephone	—	—	5.82	2.20
Utilities	—	—	2.25	0.85
Pers. Property Tax	—	—	1.98	0.75
Contracted Services	—	—	0.32	0.12
TOTAL	$142.93	56.26	$168.65	63.77
Central Office	$ 6.40	2.40	$ 1.59	0.60
Profit	—	—	$ 1.27	0.48
TOTALS	$266.53	100.00	$264.45	100.00

*This hearing aid specialist custom orders each hearing aid and therefore has no inventory.
**This hearing aid specialist owns his own offices.

lost time from employment, meals, etc. These costs are particularly important if a person is self-employed, works on a commission, or is ineligible for sick-leave. It is also questionable if 8 cents a mile is adequate in light of today's high costs for fuel, service and maintenance for automobiles, and the high cost of public transportation in general. In most major cities, for example, bus fares are generally much higher than 8-cents a mile, even with special rates for handicapped and elderly persons.

On the other hand, the hearing aid specialist provides hearing aid fittings in the veteran's own community, and even in his own home. This eliminates the need for the veteran to leave home, lose time from his employment, or spend money from his own pocket for meals and supplementary transportation costs to obtain a hearing aid fitting. And the hearing aid specialist's travel cost per fitting is only $4.76, considerably less than that attributed the VA system.

Both the hearing aid specialist and the VA attribute about the same percentage of the hearing aid fitting cost to depreciation. However, while the VA computes "the annual depreciation applicable to audiology equipment based on the useful lives of the equipment" and applies "the percentage of audiology time related to providing hearing aids to this total" and computes "an average cost by dividing the number of hearing aids issued into the depreciation cost applicable to issuing hearing aids," the hearing aid specialist attributes all his equipment, furnishings and facilities depreciation to this percentage.

Perhaps the most significant aspect of Table C is that a hearing aid specialist pays nearly 14 percent of each fitting cost in outside professional services, education, advertising, promotion, dues and subscriptions, interest, postage, rent, equipment repair and maintenance, office supplies, telephone, utilities, personal property taxes, and contracted services. The VA apparently pays only 1.12 percent for these "other" costs.

The earmark of efficiency of the hearing aid specialist compared to the VA clinic may also be found in the fact that the dealer attributes only 0.6 percent of a fitting cost to administration, while the VA attributes about 2.4 percent.

Finally, despite all the criticism that hearing aid specialists make a profit of 200 to 300 percent, we find that the dealer's profit is actually less than one-half of one percent (0.48%) per fitting. Unfortunately, it is easy for salaried government employees to make such charges because, generally, they are not familiar with private enterprise "cost of doing business." Such confusion between "markup" and "profits" is understandable, but not justifiable.

It is also important to realize that the profits of the hearing aid specialist in large measure are normally ploughed back into the business in the form of new equipment and furnishings, larger and better quarters, and for hedges against future increased costs such as salary increases for personnel, increased insurance rates, higher taxes, postage increases and higher costs of products, utilities, services, advertising, etc., due to inflation.

On the other hand, GAO does not in-

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NHAS Analysis . . .

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clude anywhere in its VA clinic accounting an indication of where the money for these future costs comes from. While the VA may make no profits on the fitting of hearing aids, their operating funds are provided by the taxpayers, including hearing aid specialists who pay much of their "profits" in taxes. Thus, ironically, hearing aid specialists are "subsidizing" VA clinics to do what hearing aid specialists can do more efficiently, with less expense and with more convenience to the hearing impaired veteran.

Observations

FACT: The hearing aid dealer: employs people at no cost to the taxpayers; provides medical care and pensions for himself and his staff at no cost to the taxpayers; delivers services to the veteran's door at about one-third the cost that the VA pays the veteran to travel to a clinic, and does it at no cost to the taxpayers and at no additional cost to the veteran; pays all business expenses at no cost to the taxpayer; pays a substantial amount of direct and indirect taxes to local, state and federal governments at no cost to the taxpayer; makes about 0.48 percent profit on each fitting at no cost to the taxpayer; and provides all after-fitting counseling and services to the veteran, if necessary in his own home, at no cost to the taxpayer.

FACT: The GAO concludes: "At the clinics visited it cost an average of $199.90 to provide a hearing aid to a veteran. The costs reviewed appeared reasonable and in GAO's opinion the two Administration clinics visited were neither overstaffed or underutilized."

In light of the NHAS analysis of the GAO report, it is apparent that the government cost accounting system can be questioned. Somehow it is not enough to lump under a category of "other" such costs as outside professional services, education, dues and subscriptions, postage, rent, equipment repair and maintenance, office supplies, telephone and utilities. This "lumping" should particularly not be employed when comparisons between clinic and free enterprise systems are being made.

It is patently misleading to compare the VA's wholesale purchase price from hearing aid manufacturers with its purchase price at retail from a hearing aid dealer.

More importantly, it is totally misleading to use the "cost of hearing aids issued" when most veterans receive two hearing aids and clinic costs are "averaged" between the two. It is particularly misleading when the clinic half-costs are compared with dealer full-costs.

The GAO's ability to ignore inflation in the cost of anticipating future services is incomprehensible. While a dealer must stockpile "profits" as a hedge against future costs, GAO permits the VA to assume money for new equipment, furnishings, facilities, for salaries and fringe benefits, and for supplies and services, will automatically appear at no cost to anyone.

The GAO also ignores the fact that private enterprise must pay taxes. In addition to direct taxes reflected in personal property taxes, personnel taxes and postage, the hearing aid dealer must also pay many indirect taxes. For example a large percentage of salaries, pensions, costs of outside professional help and contracted services and profits ultimately are paid as income taxes. Sales taxes are also collected by state and local governments on all products equipment and supplies purchased and sold by the hearing aid dealers. Then there are hidden taxes on advertising, dues and subscriptions, rents, telephone and utilities. When all these direct and indirect taxes are subtracted from the dealer cost per fitting, it can be clearly seen that the VA clinic's tax-free cost of fitting a veteran with a hearing aid would be considerably more than the hearing aid specialists' costs. The hearing aid specialist's taxes, in addition, subsidize the VA clinics.

Finally, the GAO report fails to question why one-third of the veterans fitted with VA hearing aids fail to request a spare hearing aid if the VA system is successfully patient oriented.

Questions

If the GAO really did a conscientious study of the VA hearing aid delivery system, how could it call a 68 percent difference between salary costs in Albuquerque and those in Denver "reasonable", and excuse the difference with the comment, "We were informed that this lower salary cost is due to the Albuquerque clinic being understaffed, according to VA staffing criteria, for a clinic of its size"?

How could GAO ignore the fact that Denver clinical audiologists are working "full-time" for only 28.8 hours a week?

And why does it take some 9.24 staff manhours to fit a hearing aid in Denver, and 6.22 manhours in Albuquerque, especially when hearing tests were presumably administered previously during the veteran's medical evaluation?

What is the role of the medical ear specialists in fitting veterans with hearing aids? Is there no medical supervision of these fittings? If there is, why are not the otologists' salaries and time included in the GAO analysis?

What is the role of the trainees? How much actual time do these trainees spend with each veteran? Are they always under the direct supervision of the clinic audiologists? Is this time considered to be time spent "working with patients" or time spent "doing research and class work toward their advanced degrees"? Why?

If the time spent by clinic personnel conforms to the "standards" established by ASHA, and if the GAO analysis indicates that these "standards" are less than "productive" to the taxpayers who pay the bill, should new "standards" be set by someone else?

How can GAO justify clinical audiologists in Denver being paid $33,315.36, and the Albuquerque clinical audiologist being paid $35,399 annually, when the VA says their salaries should be about $70,585.20?

Why does GAO compare the VA wholesale purchase price from manufacturers to the VA retail purchase price from hearing aid specialists and conclude that the VA wholesale procurement price is less expensive? Doesn't the GAO understand the difference?

Why does GAO refuse to include all operating costs of VA clinics in its analysis? Is the reason justifiable that "the audiology clinics were such a small part of the total hospital operation" that GAO "did not attempt to allocate hospital costs for administrative support services to the hearing aid program"? Can this be justified when GAO's analysis includes such costs for dealers when comparisons between hearing aid specialists' costs and VA clinic costs are made?

How can GAO include dealer taxes that are used to "subsidize" the tax-supported VA clinics in comparing dealer and VA clinic costs? Especially interesting is the fact that only salaries are apparently taxable under the GAO's cost accounting system, while hearing aid specialists' costs in many instances reflect a high rate of both direct and indirect local, state and federal taxes. Why doesn't GAO make allowances for this factor?

What are the exact duties performed by the VA clinical audiologists? Are tests, evaluations and fittings being done by trainees without clinical audiologist supervision? Are any of these clinical audiologists engaged in other pursuits? If so, what are they, and why?

And finally, we must ask the most important question: if the VA system is successfully patient-oriented, why do one-third of the veterans fitted with VA hearing aids fail to request a spare hearing aid? Why? ■

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Are Veterans Shortchanged By VA Hearing Aid Services?

"Veterans in need of hearing aids sometimes give up in despair and decide the cost of 'free' hearing aids is too high."

Introduction

A RECENT report by the Comptroller General of the United States, titled "Costs to Operate the Veterans Administration Hearing Aid Program" indicates that the taxpayers are paying through the nose to provide hearing aids for veterans, who, in turn, are sadly inconvenienced by the VA "service", compensated poorly for travel time to VA centers and time lost from work, and are probably receiving less of the essential follow-up care than if they were allowed to obtain their hearing aids from the private sector.

The report, which incorporated the VA's own views of its operations, attempted to justify the VA's hearing aid program. Instead, it shows that it is strangled by red tape, and even the Comptroller General of the United States couldn't identify and compute all the costs of the program.

Buried in the comments, footnotes, and elaborate charts and figures is indisputable evidence that the VA's hearing aid program is inconvenient, more costly than they want to admit, with quality of service questionable. Veterans in need of hearing aids sometimes give up in despair, and decide that the price of their "free" hearing aid is too high, and turn to the private sector for the relief from hearing loss which they seek.

VA Service Is Inconvenient

The Comptroller General's report showed that there are 45 VA clinics involved in the VA's hearing aid program. One may be led to conclude that that is amost one per state, and therefore, most veterans have easy access to a VA audiology clinic. Not so. Analysis of the data contained in the Report shows that nineteen states do not have such services, even when "contract clinics" are included, and *many veterans would need to travel hundreds of miles to obtain hearing aid services from the VA*. The states without a VA audiology clinic are Alabama, Alaska, Connecticut, Delaware, Hawaii, Idaho, Kansas, Maine, Maryland, Nebraska, Nevada, New Hampshire, North Dakota, Rhode Island, South Dakota, Vermont, West Virginia, Wisconsin, and Wyoming.

Meantime, through the mysteries of allocation of tax funds, several states have two or more VA audiology clinics. These are California, Florida, Louisiana, Michigan, Missouri, New York, Pennsylvania, and Texas. **So, the veterans do not have equal access to services.**

Consider especially what this means to the veteran with multiple handicaps, who may have difficulty walking from his living room to his bedroom, much less traveling hundreds of miles to obtain hearing aid services. And, this is not limited to just obtaining the first hearing aid. The Comptroller General's report says, "Eligible veterans requesting an initial, replacement, or spare hearing aid are referred to the nearest VA or contract audiology clinic for hearing aid evaluation and selection of a suitable aid." It does not mention what the veteran must do in order to obtain post-fitting care, and counseling, which is recognized as an essential element in adjustment to hearing aid usage, but one must assume that the veteran would need to make the trek every time he or she needs hearing aid advice or assistance whether major or minor. Yet, this is provided routinely by hearing aid specialists in private practice.

Meantime, the Comptroller General's report says that the veteran is compensated at 8¢ a mile for travel, at a time when at least 14¢ a mile is the standard rate with most corporations. The report also says, "A review of travel reimbursements paid to veterans seen at the audiology clinics visited did not reveal ANY instances where an overnight stay was involved." Therefore, these VA audiology clinics apparently cater only to the local area, and perhaps do not encourage veterans from any distance to avail themselves of the services.

If the VA audiology clinics are therefore not equipped and able to serve the veterans adequately, how can the service be justified?

Apparently, to some extent at least, it cannot. The Report says, "When VA determines that it would not be feasible for the veteran to travel to the nearest VA audiology clinic, authority may be obtained for the purchase of a hearing aid from a local hearing aid dealer." *Anybody who has had experience with government can imagine how much red tape may be involved for the veteran to prove "it would not be feasible" to travel to the VA audiology clinic.* The Report does not elaborate, but this immediately conjures up visions of multiple complicated forms to be filled out, examinations to affirm lack of feasibility, and voluminous correspondence as the request for local service moves through the government machinery.

But, the real question is this — if the VA admits that local service is more desirable in many instances, or even SOME instances, then why not all the time? While the VA ardently defends their hearing aid program, and seeks to create a self-perpetuating system, they are forced to admit that in some cases, their service to veterans is "not feasible" and a private hearing aid specialist can do it better.

Quality of Service Needs to Be Reviewed

With the immense inconvenience this system creates for veterans, surely, the quality of service would have to be very high to justify it. While the Comptroller General's report did not seek to measure this important aspect of the program, careful analysis indicates that it may be less than desirable.

An indication that the Comptroller General may have overlooked the essential aspect of providing "hearing aid services" in addition to the hardware appears in a section in which he compares the manufacturer's cost of the hearing aid with the price when purchased from a local hearing aid specialist. In an obscure footnote, they do admit that the local hearing aid specialist also demonstrates the hearing aid, assists in selecting and fitting the hearing aid and advises the patient as to its care and maintenance while the other cost merely covers the hearing aid. However, Comptroller General blindly compares these two purchase prices — the manufacturer's price vs. price of hearing aid *plus all related services* – to claim in the main body of the report that "The average contract cost for hearing aids available directly from the manufacturers for the 1974 contract year was $105 as compared to the average contract cost of $264.00 *for the same aids* available from authorized dealers." The hearing aid may be the same, but certainly, the service is not comparable. By comparing apples and oranges, the Comptroller General biased his report in favor of government distribution of hearing aids!

Quality of VA hearing aid services also appears sadly deficient in the other areas as well. The Comptroller General tells us that the "VA has developed a program for measuring and evaluating hearing aid performance. The program provides VA with a means of selecting a manageable group of aids from among the more than 500 models available in the United States." Their table shows that out of these 500 models available to the general public, the VA makes only 28 available to veterans, severely constricting the options available to them. An article in "Consumer Reports", in May, 1971, tells how this is achieved — not necessarily on performance of the hearing aid, but on a complicated formula which they described as "cost-per-point-of-quality." They said, "The hearing aids in the VA ratings represent only 15 percent to 20 percent of the hearing aids commercially available . . . (actually, the Comptroller General's report shows that they represent only about 5½%) . . . The VA first invites manufacturers to enter aids of their choice for the testing program: . . . (The Comptroller General's report showed that in 1974, 19 hearing aid manufacturers submitted 114 models.) . . . For the qualifying aids, a price factor was introduced by dividing the performance score into the quantity price quoted by the manufacturer. The resulting cost-per-point-of-quality was the basis for awarding contracts. *Thus, the VA might not buy some aids with relatively high performance scores because they cost too much." Conversely one wonders if they buy some hearing aid with relatively low performance scores because they are so cheap.*

Is It Really Economical?

With all this emphasis on costs, and the apparent sacrifice of quality for economy, how much does it really save? The Comptroller General wasn't able to say, for sure, if it saves anything, since he pointed out, "The VA does not accumulate cost data at the level of individual programs, such as the hearing aid program." In the case of repairs, he pointed out that it was necessary to estimate labor costs, since they were "based on informal records which were not retained." In addition, he discounted what may be a major expense of the VA system, with the statement, "Also, we did not attempt to allocate hospital costs for administrative support services to the hearing aid program since the audiology clinics were such a small part of the total hospital operation. Each of the clinics in our review accounted for less than 1 percent of its hospital's fiscal year 1974 expenditures." But, *what the Comptroller General failed to recognize is that even 1% of several millions of dollars can be a significant sum, and appreciably increase the "average" cost of VA hearing aids.*

So, after all of the analysis, all of the figuring, and all of the elaborate charts and comparisons, what it really boils down to is that nobody knows what the VA hearing aid program is costing, and apparently, nobody knows how to find out.

Even with the figures which the Comptroller General presented (which, by the way, incorporated the VA's own suggestions which may have been less than objective), some interesting speculation is possible. First, out of the 45 VA audiology clinics, the Comptroller General analyzed costs of only two, which leads to questions as to why these particular two were chosen. One was called "understaffed" — which substantially reduced operating costs, and therefore, decreased the "average" cost per hearing aid issued; we have no way of knowing whether or not these clinics are "typical", so the "average" cost, stated at $199.90 may be completely irrelevant to the total VA system. *By choosing a clinic which reflected unusually low costs, and by omitting many relevant cost factors, the figures have been biased to prove a VA efficiency which may actually be nonexistent.*

At the Denver clinic, which claims to have adequate staffing, the cost of each hearing aid issued was $217.81, according to the GAO report, and *this was exclusive of administrative support services (of an undetermined amount) and costs of testing new hearing aids.*

In computing "average" salaries of staff per hearing aid issued, the Comptroller General took a "statistical sample", and applied the American Speech and Hearing Association's relative value time standards for audiology services. However, a footnote explains that "A member of the committee that developed the standards said they had not been adopted yet because of disagreement of audiologists and speech pathologists in the area of special tests." They also claimed that "the general categories of the standards used by VA are not being challenged" — Perhaps they should be. *There is no proof that this is an infallible standard, which can justifiably be used to compute salary costs of the VA system.*

The Denver clinic reportedly issued 184 hearing aids in fiscal 1974. Yet, it does not explain whether these were the initial hearing aids, requiring staff fitting services, or whether these were the "spare" hearing aids issued to the veterans since service is so hard to get through VA. The report says, "The veteran, after he has worn his aid for six months, is entitled to a second aid so he will have a spare." So, in computing costs "per hearing aid issued", the report probably reduced its "average" cost by assigning salary costs, equipment depreciation, travel costs, etc. to TWO hearing aids instead of ONE. So, the analysis would have been far more accurate if they had talked in terms of "number of veterans fitted" instead of numbers of hearings aids issued.

In other words it is necessary to nearly double the audiology clinic and central office costs for testing, evaluating, fitting and issuing two hearing aids to a veteran, and then add the cost of the hardware, in order to come closer to the actual clinical costs for fitting each veteran. *Thus, it becomes apparent that the costs of "issuing a hearing aid" are quite different than the costs of "fitting a veteran" with a hearing aid.* **So, the statistics in the report have been skewed to reduce the "average" cost.**

Are the Veterans Satisfied With the VA Hearing Aid Service?

For a select few veterans, the VA hearing aid program may be as good as the VA attempts to represent it. However, *a growing body of evidence indicates that the VA is failing miserably – in terms of efficiency, service, and veteran satisfaction.*

Following are typical comments by veterans about the VA service:

A letter to a hearing aid specialist in Oklahoma . . . "I spoke to you regarding the . . . hearing glasses furnished to me by the Veterans Administration in Oklahoma City sometime in March, 1971. I feel that they fitted me with their over-inventoried model. The nose piece does not fit my nose bridge and keeps slipping down. Some of this is probably caused by the excess weight built into these glasses. I have to put sponge nose guards on the frames to wear them at all, and for a salesman meeting the public I am quite embarrassed and don't wear them as much as I should. I have purchased three different ear molds trying to tone down the magnitude of the volume on this set. I can only use them on the lowest adjustable volume. They do not have a (brand name) dealer in Tulsa, but I did stop by one in Oklahoma City, and he was amazed that I was wearing their strongest model. Often I have thought of going back to (VA) but the inconvenience of going through the bureaucratic procedure is discouraging, and last time I really didn't feel I was getting through to them with my problem. I console myself with the fact that this must be the 'GI Issue' and it was free, but I am envious of the new delicate models I see in the windows of dealers in Tulsa."

Following are other case histories:

(Name and address deleted) — is unable to travel the 150 miles to Oklahoma City (VA center). Spends much of his time in local VA hospital in a cast. Is completely dependent upon a hearing aid and must make do with obsolete model or buy his own aid and batteries.

(Name and address deleted) — WWI veteran. His eyesight is not good enough to drive the 175 miles to Oklahoma City. Can get aids if he gets there.

(Name and address deleted) — Went to a hearing aid specialist for a hearing test. Likes the (brand name) hearing aid, and requested that he be given one. Was told that the VA did not have a contract with (this manufacturer.) Was persuaded to accept another aid. This aid has not proven satisfactory.

(Name and address deleted) — purchased a $100.00 hearing aid from a hearing aid specialist approximately 20 years ago. He wore it for several years and then applied to the VA for a replacement. They gave him a different brand, and he returned to the hearing aid specialist because he liked the original so much better. The hearing aid specialist made the necessary adjustments to the new hearing aid which made it satisfactory. Later, the client returned to the VA to get his second one. He said they didn't test him but laid two aids out and gave him his choice. He returned to the hearing aid specialist to get the second hearing aid adjusted. After using the hearing aids for a preiod of time, he wrote VA to try to upgrade to later models, but they notified him that his condition was satisfactory as it was. The client was issued body aids both times, when he could have worn, and wanted to wear, on the head aids. The client complained bitterly about service. He was disturbed that he must lose a day of work every time he has to return to the VA center for simple adjustments or repairs, so returns to the hearing aid specialist instead, "to get it done right."

(Name deleted) — World War I veteran purchased an on-the-ear hearing aid from a hearing aid specialist, which he was satisfied with, but went to the VA for an earmold, since it was free. However, the earmold they provided was not properly modified for the hearing loss, so he threw it away. But, from the experience, he learned from VA that he could get a free hearing aid. He said they gave him the hearing aid and "turned him loose." He was embarrassed to return to the hearing aid specialist, carrying the hearing aid, the dummy, the tips and the hinges in a sack, but explained that he didn't know where else to go for help.

A veteran in Silver Bay, Minnesota, about 75 miles north of Duluth, had his hearing test at the VA Hospital in the Twin Cities about two years ago, but was never able to get enough time off work to go back to get the hearing aid.

A veteran in Hurley, Wisconsin told a Duluth hearing aid specialist that he figured it cost him about $200 when he went to Minneapolis-St. Paul, over 200 miles away, for service for his hearing aid. (At least one Duluth hearing aid specialist provides service to veterans' aids, whether it is a brand he sells or not, without charge.)

Out of compassion for the plight of hearing impaired veterans, many other hearing aid specialists in private practice are providing hearing aid services, at no charge, to them, thereby supplementing a government system which is costly and inadequate, yet determined to exist.

This letter from a veteran to the VA illustrates the point. "I hope that after you read this letter you will understand why I am taking the liberty of writing to you personally. I am a veteran of World War II, with service connected disability for hearing loss, and am furnished my hearing aid and batteries by the VA, a fact which I sincerely appreciate. Last month I had trouble with my hearing aid, and after sending it in for repairs was notified that it would take longer because the repairs were unsatisfactory. Because my spare aid is very inefficient I went to (a private hearing aid specialist) and they were kind enough to test my hearing and loan me an aid which has completely transformed business and social life. I had not remembered, nor dreamed of regaining, this measure of hearing. For some reason, these (hearing aid specialists) appear to be more successful in supplying the aid which furnishes me the greatest degree of hearing satisfaction I have experienced in years. In all due respect to those who tried to help me when I've come to the Veteran's Administration for an aid, I've never been this happy with an aid. I can't start to tell you what a difference this has made in my business. I've always received the aid they said was the best for me, but I really never thought I'd hear this well again. The last time was especially disappointing. One similar to the one I am now using, on loan, was available at that time but they recommended a different one which has caused me many hours of static and intermittent sound. Repairs seemed never to fix it completely.

After thinking of the business I have lost and the finer things of life I've missed because of having a hearing aid inferior to my needs I am now asking you to authorize me to purchase a hearing aid locally (from private hearing aid specialists.) Hoping you will understand, (Signed with name, address, and VA file #.)

Has the VA System Outlived Its Usefulness?

An article from the *Detroit News*, Thursday, December 11, 1975, suggests that "*The nation would save money and serve its veterans better by closing its Veterans Administration (VA) hospitals and paying private and community medical facilities to care for their patients, a study suggests*. That's the recommendation of the study by Cotton M. Lindsay, professor of economics at the University of California at Los Angeles . . . 'Veterans needing treatment frequently live far from a facility,' he said. 'Hawaii and Alaska, for example, do not even have a veterans' hospital'. . . Measures now before Congress would authorize further expansion associated with the Vietnam war and Lindsay feels that legislation would only lead to more wasteful spending and lower quality care for veterans. 'It is important that current proposals be considered carefully in terms of the questions raised, and should not, as seems frequently to be the case, be weighed in terms of the merits of showing appreciation for those who have borne arms in their country's defense.' "

Can the Private Hearing Aid Delivery System Do It Better?

Without question, in all areas analyzed, the private hearing aid delivery system is ready and able to deliver the services more economically, and with greater consideration for the needs of the veterans.

Consider these factors:

Fact: The hearing aid specialist pays slightly more for a hearing aid at wholesale than the VA, but his supply service costs are less because he "special orders" his hearing aids and earmolds, to reduce inventory costs.

Fact: The hearing aid specialist employs personnel at no cost to the taxpayers, and, in fact, these people all contribute taxes to the support of the government.

Fact: At no cost to the taxpayers, the hearing aid specialist delivers services to the veteran's door at about one-third the cost that the VA pays for the veteran to travel to a clinic.

Fact: The private hearing aid specialists have economic incentives for efficiency and consumer satisfaction based on competition. These incentives do not exist in the VA system.

Fact: The private hearing aid specialists can provide a wider range of choices in hearing aid selection than the VA, which uses only 28 models out of the 500 on the market.

Fact: Hearing aid specialists are geographically distributed in direct ratio to the general population, whereas VA audiology clinics are distributed according to apparent federal logrolling.

Fact: **Many veterans feel the VA system and services have not lived up to promises.** ■

Persons wishing to review details of the report of the Comptroller General, General Accounting Office of the United States, may refer to the *Hearing Aid Journal*, February, 1976, page 12, or obtain a copy of the full report from Elmer B. Staats, Government Accounting Office, Washington, D. C. (In writing the GAO, please refer to report Number B-182457.)

the JOURNAL —
Topic-of-the-month

JOSEPH LUCKE

A Cost / Effective Analysis
of the
VA Hearing Aid Delivery System

By THE NHAS STUDY COMMITTEE

This study examines the VA hearing aid delivery system and the probable results of using it as a model for federally-funded nationwide programs under future legislation.

The Veterans Administration hearing aid delivery system costs the American public at least $708.79 per fitting for the life of the hearing aid; and the costs are probably much higher, according to a new study released on June 27 by the National Hearing Aid Society. According to the study committee's analysis, the cost per initial fitting is at least $341.17, and the cost of services, repairs, batteries, etc., for the eight-year life of the average VA hearing aid is an additional $367.62, for a total of $708.79.

The cost figures were determined from a series of correspondence, public presentations and documents from the VA which were gathered and analyzed by a NHAS study committee for the past year. The committee chairman is **Joseph Lucke**, NHAS past president, Miami, Fla. Committee members are **DuWayne Tremmel**, NHAS governor, Marshfield, Wisc.; **John H. Young, Jr.**, Columbia, S. C.; and **Floyd Loupot**, Pasadena, Calif.

Sources and Cross-Checks

Cross-check analysis, using different VA sources, factors and methodologies, produced figures that were all in the same range. The supporting data have been released to the media and other interested organizations. (Editor's note: Some 70 pages of supportive data accompanied this article but space limitations do not permit full reproduction here.)

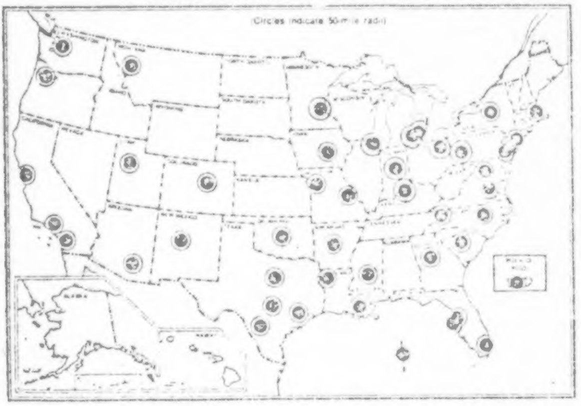
One method, based on correspondence with a VA official in July, 1974, produced an initial fitting cost of $349.87 for fitting one hearing aid to a veteran. A second method analyzed the hourly salaries of VA audiology clinic personnel, per-unit hardware costs, and identifiable overhead; the total cost per fitting from this analysis was $352.29. A third method analyzed the total costs of all salaries, hardware and overhead for a total of $341.17. To these three "initial fitting" costs must be added the costs of salaries for annual post-fitting counseling, repairs and batteries for the eight-year life of the hearing aid, this total being $367.62. Thus, the three methods produced totals of $717.49, $719.91, and $708.79. A slightly different method, based on figures given in a May, 1975, speech by a VA official and computed on the basis of administrative costs per outpatient visit for salaries, overhead, the average cost of the hearing aid and earmold plus batteries, accessories and repairs, gave a figure of $666.13 per veteran for the eight-year life of the hearing aid.

Not included in any of these computations are personnel vacation, sick leave, medical care, retirement and other fringe benefits provided federal personnel in addition to salaries; the equivalent cost of mailing hearing aids and batteries which are covered by the VA's franking privilege; amortization of equipment and facilities; the loss of tax revenues from hearing aid sales; and numerous other factors that are a normal part of doing business in the commercial sector.

A problem in developing this study was the conflicting and sometimes irreconcilable information offered in various "official" statements and correspondence. This is not to say the conflicts were deliberate or meant to be mislead-

(Continued on Page 52)

Veterans Administration Audiology Centers



VA Delivery System

(Continued from Page 8)

ing. Some were apparently due to faulty information sources or to projections of figures. For example, one VA official in June, 1974, reported there were 90 VA hearing aid centers, with a potential of 130 centers by 1977. Yet, the best documents show only 45 centers at the present time.

Another discrepancy arose in determining the lifetime of the average VA hearing aid. In June, 1974, a VA source reported an average "life" of eight years; another letter at the same time gave a figure of five to seven years; and later, in May of this year, the figure was again raised to eight years, the one finally used by the committee in its study.

Substantive figures for the cost of batteries were also hard to come by. Various battery costs were given during the same time period. An average battery cost of 14 cents each was provided in one instance, and 15 cents in another; yet a copy of the manufacturer's bid summary showed the bid cost was an average of about 25 cents each.

Clinic Personnel and Salaries

VA figures show a total of 332 speech pathology and audiology professionals in its speech and hearing clinic system (183 speech pathologists, 149 audiologists). There are also 238 trainees, of whom 107 are audiology-trainees; and 82 clerical personnel, of whom 38 are assigned to the audiology division — an average of 3.32 audiologists, 2.38 trainees and 0.82 clerks in each of the 45 VA audiology clinics.

"Approximately 25% of the overall audiology time and work load is assigned to hearing aid-related duties," according to a May, 1975, VA statement. With a 40-hour work week, the audiologists in each clinic spend 33.2 hours weekly on hearing aid-related duties (3.32 audiologists x 40 hours x 25%); trainees spend 23.8 hours and clerks 8.2 hours weekly. VA audiologists' salaries averaged $19,078 annually, or $9.17 hourly, according to the VA's November, 1974, letter; trainees received $4,660 annually, or $3.71 hourly; and clerks received $8,608 annually, or $4.14 hourly. This works out to an average $420.95 in salary costs alone each week in each VA clinic for hearing aid-related duties.

Aids in Use and Services

A VA spokesman said in May, 1975, that there are 44,000 veterans wearing 74,000 hearing aids at the present time, and he added: "Eligible veterans are routinely provided spare aids, but not every veteran has requested a spare hearing aid." These figures indicate that nearly one-third of all eligible veterans have not asked for a spare hearing aid, despite the obvious advantages, and the fact that it can be obtained at no expense to the user. The VA reported it dispensed 11,099 hearing aids in 1974. Using the ratio of hearing aids to veterans, it would appear that 6,659 veterans were fitted with VA hearing aids last year, some with two and others with one.

Significantly, the VA figures lead to the conclusion that on the average only 44% of the veterans eligible for annual services actually return to obtain these services. And, as indicated before, nearly one veteran in three fails to request a spare hearing aid. This aspect of the system is touched upon only lightly — if at all — by VA spokesmen. The only clear statement found by the NHAS committee, stated:

"Our 45 audiology centers serve a geographic area which requires some amount of travel for veterans to obtain a hearing aid. However, most clinics accomplish the entire hearing aid evaluation and all the accompanying services in one day. That one day typically includes travel time. Some eligible veterans have infirmities that make it too difficult for them to travel to one of our 45 regional audiology centers. In such cases, we authorize procurement of an appropriate instrument from a local hearing aid dealer.

"We realize that other veterans occasionally use the services of local hearing aid dealers. Problems do arise which can be handled most efficiently and expeditiously by the local dealer if the veteran lives some distance from the VA installation . . . "

The travel problems of veterans seeking services in the 45 regional audiology centers is illustrated by the map. The circles have a radius of about 50 miles, the distance of a 100-mile round trip for a veteran at $8 per trip ($0.08 per mile).

A "Model" System

The VA system has long been considered the "model" system by many clinical audiologists. Kenneth O. Johnson, Ph.D., executive secretary of the American Speech and Hearing Association, and formerly head of the VA program, stated in a **Hearing Aid Journal** interview in May, 1974: " . . . In my view, there is no reason why such a system should not be made available to beneficiaries of other federal programs. In years past, I have made this same suggestion before other Committees of Congress and before various of the federal administrative agencies. I suspect I will continue to make this suggestion because, though I am aware of its impact on the present dealer system, it is, in my view, clearly of benefit to the hearing handicapped who are eligible for other services under the Medicare law."

This study committee recognizes that the VA system may be attractive to the veteran if he can avail himself of its benefits. It provides free medical and audiological checks, free hearing aids, paid transportation and lodging costs, and an average of 3 hours and 19 minutes of a VA audiologist's time.

But the system clearly would not be feasible on a nationwide basis to serve an estimated 11.5 million hearing handicapped persons . . . not without monumental bottlenecks and perhaps insuperable barriers, plus heavily subsidized audiology clinics at enormous expense to American taxpayers.

Conclusion

The **ASHA Journal**, June, 1975, reported that 14,226 members hold Certificates of Clinical Competence. An article in the January, 1975, issue of that journal states that 21% of ASHA members with CCC's are competent in audiology and in both audiology and speech pathology, and 79% hold CCC's in speech pathology alone. This would indicate there are just under 3,000 ASHA members who are considered clinically competent in audiology. Assuming that all CCC audiologists were to work 40 hours a week, 52 weeks a year, doing nothing except hearing aid-related work, at a VA patient-work load rate of 3 hours and 19 minutes per patient, each CCC audiologist could serve no more than 627 hearing impaired persons a year.

Therefore, CCC audiologists under ideal conditions could handle no more than 1,872,849 clients a year. This would be only 74% of the 2.5 million current hearing aid users, and only 16% of the potential 11.5 million users. One can only conclude there are not nearly enough audiologists with CCC's to serve the potential number of hearing handicapped persons under federal and state hearing aid purchase or subsidy programs.

What's more, not all CCC audiologists are in clinical settings where they directly serve the hearing handicapped. Many are in research, teaching, administrative or government work. Even CCC audiologists in clinical settings have only limited time available for hearing aid-related duties because of their other hearing rehabilitation responsibilities. It should be recalled that the VA gives a figure of only 25% of their audiologists' time being devoted to hearing aid-related duties.

Therefore, any federal or state legislation that would mandate audiological evaluations, hearing aid selections, "prescriptions" and checks based on the "model" Veterans Administration system would erect significant and insurmountable barriers to better hearing health care for America's 11.5 million potential hearing aid users. ■

PRELIMINARY ANALYSIS OF COST FIGURES
ON HEARING AID DISPENSING
PROVIDED BY THE VETERANS ADMINISTRATION

The following analysis is based on letters from Dr. John D. Chase, VA chief medical director, to Senators Strom Thurmond and Ernest F. Hollings in July 1974, and to the National Hearing Aid Society in October 1974.

1. The VA reports paying an average cost of 14¢ each for batteries. Battery manufacturers say that's impossible. The minimum cost possible, they say, is 21¢ (one manufacturer said 28¢). And volume alone would not account for a significantly lower price since five medium-size hearing aid dealers together probably dispense as many batteries as the VA annually. In previous letters to Senators Thurmond and Hollings, Dr. Chase said that a 90-day supply of batteries cost $2.94. At 14¢ each, this means the average veteran uses 21 batteries in three months, or 84 batteries annually. In the latest letter, he says the number is 48 annually.

2. Also in the letters to the Senators, Dr. Chase said the majority of veterans receive two hearing aids. Thus, while 12,076 hearing aids were dispensed last year by the VA, we can assume that some 6,038 veterans received hearing aids.

3. If 12,076 hearing aids were dispensed last year to 6,038 veterans by 300 staff professionals in 45 clinics, and if 20 percent of the staff time is devoted to hearing aid-related duties, that is the equivalent of 1.33 professionals in each clinic working full time to dispense 5.15 hearing aids to 2.57 veterans weekly.

4. If the average audiologist receives $18,080 annually (that does not include any federal fringe benefits which the taxpayers pay), 1.33 audiologists would receive the equivalent of $24,046.40 annually. That is $462 weekly. Or to fit 2.57 veterans costs about $180 in professional salaries per veteran. Assuming a 40-hour week, the 1.33 audiologists would receive $11.55 per hour. At this rate, a $180 fitting requires more than 16 hours to accomplish. This is in addition to the regular audiological workup for compensation and eligibility determination provided by the other 5.32 professionals not engaged in hearing aid related duties.

5. If the VA dispensed 12,076 hearing aids last year at a cost of $1,064,274 from the manufacturers, the average cost per hearing aid is $88. Therefore, according to the figures provided, it costs the VA $180 for professional services, plus $88 for the hardware for a total of $268 to fit and dispense a hearing aid, with an additional aid provided at a cost of $88. This does not include earmold, cords or tubing. In the letters to Senators Thurmond and Hollings just 3½ months ago, Dr. Chase said

the total cost was $219 for everything, including overhead and six hours of group counseling after the fitting. Yet, in the October letter, Dr. Chase says veterans "return for resolution of problems approximately once annually after receipt of the hearing aid.

6. Please note that no overhead costs for floor space, parking space, utilities, federal payments to municipalities in lieu of taxes, cost of franking privilege (taxpayers pay this), packaging, or handling are included in the October figures. Salaries of other personnel are also omitted (the VA assumes that their 230 trainees merely stand around being educated at no expense to the taxpayers and without working on hearing aid-related duties... and that the 80 clerical personnel spend no time keeping records on hearing aids). The October letter also omits the cost of National Bureau of Standards inspection ($80,000, according to the July letter), and the cost of procurement and stockpiling ($84,000).

7. Neither does it include the effects on and costs to the veteran. For example, we don't know how far the average veteran must travel to obtain services when his hearing aid goes bad; how much time and income (if self-employed or without sick leave benefits) he loses from work; if he has other handicaps, how much is paid to a companion to travel with him; how much he is paid for travel expenses and overnight lodging, if any; etc.

8. Nor does it mention how many hearing handicapped veterans are not wearing their VA hearing aid, and how many are receiving services at no cost from understanding local hearing aid dealers who regularly see the hardships this VA system imposes on hearing handicapped veterans.

9. In the October letter, Dr. Chase says veterans return only once annually for services. However, a recent independent study shows that the average hearing aid user who buys from a hearing aid dealer voluntarily returns periodically to the dealer for an average of 12 hours counseling during the life of the hearing aid. In-depth interviews with these people indicate that they continue to require this much attention whether they are wearing their first or their 10th hearing aid. Perhaps if the VA clinics were more accessible to the veterans, VA hearing aid services would be required more frequently.

10. Please note the discrepancies on the number and cost of repairs between the July and the October letters:

	July	October
No. of small repairs	10,927	3,351
Av. cost of small repairs	$1.83	$11.61
Factory repairs	16,587	11,367
Av. cost of factory repairs	$14.77	none given

11. In the next to last paragraph of the October letter, Dr. Chase mentions the bad experience VA had with "various categories of sub-professional personnel" examining veterans for compensation award and hearing aid eligibility services. In nearly all these cases, audiologists (a profession spawned and trained by the military and VA after World War II) were employed for this purpose. Hearing aid dealers were permitted to fit a hearing aid at government expense only after a VA decision was made. Further, a veteran was permitted to "shop around" among three hearing aid dealers of his choice prior to purchase. In this way he could select the hearing aid that sounded best to him from a wide variety of possibilities the dealers offered. Now, the VA tells him which one he will wear -- usually without adequate trial of the many possible aids the VA offers, and from a stockpile of hearing aids that are predominantly of foreign manufacture. In some cases, we understand, veterans are wearing hearing aids manufactured by the country they were fighting against when they lost their hearing in the first place. While foreign instruments are, in most cases, less expensive than American-made hearing aids, our hearing aid dealers have found through experience that they are generally of much lower quality, break more readily, and are more difficult to have repaired and serviced.

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SIGNIFICANT QUOTES

The following quotations are excerpted from a letter by Dr. John D. Chase, chief medical director of the Veterans Administration, to Senator Ernest Hollings dated July 15, 1974:

". . . A key aspect of the hearing aid program is our method of procurement. . . . we consider this part of the program to be an effective and practical approach to hearing aid selection."

". . . hearing aids cost the government (in 1973) $1, 463, 177 for an average acquisition cost of $104. 64. For the aids presently on contract the price range is from $69. 50 to $144. To cover cost of measurement by the National Bureau of Standards ($80, 000) and to pay the cost of procurement, stock control and shipping ($84, 000), the VA Supply Service sells these instruments to each of the VA and other government clinics at an added charge of 14%. The average cost rises from $104. 64 to $119. 00. . . stock levels are maintained in the VA Supply Depot and stock levels are maintained in individual clinics. . . ."

". . . Veterans apply to nearest VA center. He is given an appointment for an otological examination. . . then audiological. . . . If aid is prescribed . . . VA Supply Depot sends a 90-day supply of batteries that cost $2. 94 on the average."

". . . VA issued 1, 672, 287 batteries (1973) at a cost of $233, 610. That's an average of 14¢ apiece. . ."

". . . Minor repairs and maintenance services are completed at the center (Denver). . . instruments needing factory repairs is sent to the manufacturer or other commercial repair facility. The repaired aid is tested at the center to determine if it is satisfactory before being returned to the veteran. . ."

". . . in 1973. . . 16, 587 repairs were made by commercial resources at an average cost of $14. 77. . . . Prosthetic distribution center made 10, 927 small repairs. . . providing tubing, cords, receivers, etc., at an average cost of $1. 83. . . . For hearing aids currently issued, there is a two-year warranty. . . . Studies have shown that the majority of veterans retain their hearing aids on an average of from 5 to 7 years. . ."

". . . preliminary study has shown that it costs the Veterans Administration $219 to issue a hearing aid. This includes:

1. Cost of aid
2. Professional and clerical services
3. Earmold
4. Overhead at the rate of 38%

This figure includes six hours of an audiologist's time spent in counselling auditory training and orientation with patients on a group basis. . . . The cost of the building, equipment, and staff of the hospital, as well as the audiology clinic itself are there for examination and treatment of veteran's disabilities. Only 20% of the total clinical time of the VA audiology clinics is devoted to hearing aid evaluations.

"...However, most clinics, including the one at the Columbia VA hospital which serves veterans from the South Carolina area, accomplish the entire hearing aid evaluation and the accompanying services in one day. That one day usually includes travel time.... Therefore, lost time from employment was not included in the hearing aid evaluation cost computation...."

- O -

The following quotation is excerpted from a letter by Dr. Robert Stewart, director, Prosthetic and Sensory Aid Services, Veterans Administration, to Joseph C. Lucke, then president of the National Hearing Aid Society, dated June 29, 1972:

"...827 (trainees) have been trained in the VA Audiology and Speech Pathology since inception. Of these 496 have received training as audiologists and 311 as speech pathologists....64 now employed as audiologists and 62 as speech pathologists....It is estimated that minor repair services performed in the Prosthetic Distribution Center at Denver takes about an average of 7 calendar days from the time the veteran sends his aid in until he gets it back....factory service...estimated about 18-21 days from time veteran sends his aid until the time he gets it back..."

FACT SHEET

The facts and figures used in this fact sheet are based on letters from Veterans Administration officials to Senators Strom Thurmond and Ernest Hollings, and to National Hearing Aid Society Past President Joseph C. Lucke. Copies of this correspondence are attached.

Utilization of Facilities and Personnel

Supplied Facts (1971):

No. of VA centers dispensing hearing aids...............34
No. of VA contract clinics............................. 3
No. of audiologists and speech pathologists employed.....209
(NHAS estimate of 180 not disputed)
No. of "trainees" employed (NHAS estimate not disputed)..175
Total No. of professionals and trainees employed
(conservatively using NHAS figures)............. 355
No. of hearing aids dispensed by VA to veterans in 1971..8,125

Comments:

Average no of hearing aids dispenses in 1971 per
VA center and contract clinic.................. 219. 59
Average no. of aids dispenses per center per week..... 4. 22
Average no. of aids dispenses per center per day....... 0. 84
Average no. of professionals and trainees per
clinic (conservatively using NHAS figures)...... 9. 59

Conclusions:

355 professionals and trainees in 37 centers
distributed 8,125 hearing aids in 1971
9. 57 professionals and trainees in average center
distributed 219. 5 hearing aids in 1971
9. 57 professionals and trainees in average center
distributed 4. 22 hearing aids per week in 1971
9. 57 professionals and trainees in average center
distributed 0. 84 hearing aids per day in 1971
Average professional and trainee in average center
distributed 22. 88 hearing aids in 1971
Average professional and trainee in average center
distributed 0. 44 hearing aids per week in 1971
Average professional and trainee in average center
distributed 0. 08 hearing aids per workday in 1971

NATIONAL HEARING AID SOCIETY
24261 Grand River • Detroit, Michigan 48219 • Telephone 537-2610

Executive Secretary
ANTHONY DiROCCO
OFFICERS AND GOVERNORS
President
JOSEPH C. LUCKE
Miami, Florida
Vice President
ALFRED R. DUNLAVY
New York, New York
Secretary-Treasurer
NORMAN P. KRAMER
Davenport, Iowa
Legal Counsel
RICHARD A. KITCH
Detroit, Michigan
GOVERNORS
Canadian
WILLIAM F. [illegible]
Montreal, P.Q.
Northeast Coast
ALFRED R. DUNLAVY
New York, New York
Central East Coast
LESLIE N. KUTOK
Vineland, New Jersey
Southeast
CHRIS E. CHILDRESS
Greenville, S. Carolina
Central East
JOHN C. KENWOOD
Fort Wayne, Indiana
Southwest
ROSS IRWIN
San Antonio, Texas
Central
NORMAN P. KRAMER
Davenport, Iowa
Northwest
MARVIN H. [illegible]
Colorado Springs, Col.
Pacific
ESTHER B. DANIEL
San Bernardino, California
Governor at Large
RAYMOND Z. RICH
Cleveland, Ohio

REMARKS OF
JOSEPH C. LUCKE, PRESIDENT
NATIONAL HEARING AID SOCIETY
IN
CONFERENCE AT THE VETERANS ADMINISTRATION
WASHINGTON, D. C.
APRIL 18, 1972

The National Hearing Aid Society appreciates this opportunity to exchange information and to explore the possibilities of the Veterans Administration utilizing the facilities and services of some 5,500 small businessmen employing 20,000 people.

We are primarily interested in the VA delivery system for hearing aids to partially hearing veterans. We believe there is room for improvement in terms of convenience to the veterans you seek to serve and that a frank and open discussion of current procedures may point to ways of improving and streamlining these procedures. Perhaps an amalgam of government services and greater utilization of private resources would better serve the veteran, with a welcome side effect of greater efficiency and economy.

Under the present system, veterans must often take a day or two off work and travel many miles to obtain hearing aid help -- help that could be procured locally through commercial channels without appreciable loss of time to the veteran. For the multiply-handicapped veteran, travel to a distant VA center may not only be inconvenient, but a physical hardship as well. Moreover, the hearing aid dealer stands ready to travel to the home of a veteran who might be too severely handicapped to travel at all.

Most towns of any size offer the community a choice of several different dealers. In addition, many dealers serve rural communities too small to support a full-time dealership on a regular basis.

Moreover, because the dealer is located right in or near the veterans community, the dealer is ever ready to serve the veterans needs after the hearing aid has been delivered. Rarely does a "stock" hearing aid suit the needs of its user. Major and minor adjustments have to be made in terms of comfort and wearability; internal or external acoustical adjustments may be necessary; and the new wearer may require patient and understanding encouragement as he goes through the sometimes difficult period of learning to use a hearing aid.

None of these vital services are readily available to the veteran who has the misfortune to live far from a VA center. Fortunately for many of these veterans, local hearing aid dealers often do perform these services for the veterans free of charge. But, gentlemen, is this fair to the dealers or indeed to the veterans?

Perhaps there is some feeling on the part of VA personnel that there is a lack of competence in the otological, clinical and commercial sectors of the hearing health team outside the VA system. If so, we surely ought to discuss this. If not, we should talk about opening the doors of convenience to our veterans by allowing them to avail themselves of already existing services right in their own communities.

Of course, central to our whole discussion is the fact that we should regard the veteran as a consumer -- in this instance, a consumer of services provided or paid for by his government. There is perhaps no one more deserving of the best this country has to offer than one who has put his life on the line in service to his country.

Gentlemen, progress was never made by looking backward, nor is there any progress in standing still. We don't need to reflect negatively on past or present programs here today. Better, let's use this opportunity of our meeting here today to find ways to provide the best possible service that we -- government and private industry -- can render to our veterans.

Before we get into full and open discussion, there are a few questions we would like to ask which we hope will give us a factual basis from which to proceed:

1) How many regional centers for audiological services now exist? How many contract clinics supplement these?

2) How many hearing aids were issued to veterans during the last fiscal year?

3) How many veterans received hearing aids, under both schedules A & B. How many fittings were Cros and binaural?

Senator HAYAKAWA. Gentlemen, in each of your statements you concede that you run into unfair competition offered by the Government or by universities. I am sufficiently acquainted with Government and the universities myself to know that many of them think they are carrying out important public service roles, and often at a lower cost to consumers who don't know that the taxpayers support the system. But just let me take a hypothetical example from any one of your fields. Supposing you have fairly expensive testing equipment for hearing aids, for solar energy, or whatever. Supposing you need this as a teaching instrument in your university. Supposing furthermore that having used it as a teaching instrument, there is time left over for this equipment to be used otherwise. Then, of course, the temptation is almost irresistible, is it not, to offer the use of this equipment at substantially reduced rates from what you can charge, and therefore make life tougher for all of you. I want to ask you, is this conflict invevitable or are there some rules under which this kind of competition can be controlled or removed? Do you want to remove this type of competition entirely? If the university invested half a million dollars in very expensive and sophisticated equipment, and they have only five or six Ph. D. candidates in a particular field, that testing equipment is going to lie idle a lot of the time. How can a university justify that expenditure, or should they even have purchased it in the first place? Would you like to answer that question?

Dr. EVANS. Yes, I would like to comment on that very specifically.

Senator HAYAKAWA. You have had both connections, after all.

Dr. EVANS. When I joined the Materials Research Laboratory (MRL), at the University of Illinois, the laboratory director was Prof. Robert J. Maurer from the faculty of physics. In my judgment, he was the most responsible laboratory administrator I have ever had the pleasure of serving. As an example of his thoughtful leadership, if four or five faculty members decided they needed some "solar powered widget," he would not say, "oh that's great—we've got the money—let's go buy one." On the contrary, he would say something like:

> How will this widget impact the overall program? Will other researchers benefit from the equipment? Will we have sufficient operating support, staff, etc., needed to keep the widget running, not just next year, but for several years into the future?

If these types of questions could be satisfactorily answered in an affirmative way by the requestors, then and only then would a purchase be made, that is, after careful consideration and comprehensive assessment. Often he was accused of obstructionism and was not the most popular person to many of my colleagues, but I can now clearly see his wisdom. In addition, once an acquisition was made, he established very clear guidelines for how the equipment was to be used. First priority went to the laboratory and its programs, secondarily came the rest of the university outside the MRL, and only then could we consider research outside the university, presumably work for other universities. A specific prohibition existed on our doing any work for the private sector, except for two very special cases. One, if our laboratory had a capability totally unavailable in the private sector and two, if the urgency of the situation was such that the private sector could not deliver in a timely fashion whereas we could without interfering with our own work. Such instances were extremely rare. I should point out that all of the above guidelines were established by Professor Maurer with a clear view of the role of a university, viz: education, research, and service to the public. However, he had a remarkable grasp of the distinction between "service" and infringement.

As you can see, the policy reflected the views and attitudes of the man in charge. Such will always be the case in the absence of any higher level directives. Professor Maurer has since retired and I have left the university. The current director of that laboratory, a younger and seeminly more aggressive individual, appears to have only raw empire-building in mind. Twice they have applied for regional instrumentation facility grants from NSF and twice have been denied. They have since turned to DOE and have received substantial funding for new equipment to serve "all DOE contractors". In addition, they are organizing themselves to serve non-DOE contractors from private industry as well with equipment and techniques widely available in the private sector.

The problems this type of situation creates for small business stem primarily from the lack of any guidelines for how these types of facilities should be used. Federal guidelines should be handed out along with the money to insure responsible management at the user level. Such guidelines should also be given to the Federal agencies themselves to provide an equitable and evenhanded approach across the board. Furthermore, input is needed from the private sector in establishing these guidelines. It is even conceivable that private sector input could be effectively utilized in reviewing major equipment acquisitions proposed by public sector laboratories spending public funds. The relationship between the public and private scientific communities can be cooperative and not adversarial.

Senator HAYAKAWA. Thank you very much.

Do you have any questions, Congressman?

Representative DREIER. Just along that line, just further, would you recommend some central system whereby the availability of facilities and equipment would be made to the Federal Government, and then that would be disseminated through the university system?

Dr. EVANS. The National Science Foundation's regional instrumentation facility program is along these lines. I believe there are about 15 of them in number, all at universities, spanning a broad range of scientific disciplines. My understanding is that the program is presently on hold pending evaluation. In principle, these facilities are a step in the right direction. However, they are lacking in two distinct ways. First, as I mentioned earlier, they lack the necessary guidelines to avoid establishing a competitive posture with respect to the private sector, and second, they are in need of private-sector input, perhaps even so far as to have private sector management somewhat like a few of the national laboratories. At a minimum, such input could be derived through the appropriate and judicious use of steering committees with representatives of the private sector sensitive to its needs.

Representative DREIER. If I can change the subject for a moment, Mr. Chairman, and ask Mr. Loupot, he began speaking about something I was rather intrigued with. You had worked with the House Veterans' Affairs Committee on this issue of cost of hearing aids and the cost to the disabled veteran who was actually personally saddled with it. I am curious to know a couple of things. First of all, when was that?

Mr. Loupot. About 1976, about 4 or 5 years ago.

Representative Dreier. About 5 years ago. I am curious to know, you didn't get into any of the figures of disparity between your delivery cost and the actual cost to the Veterans Administration. Do you have those?

Mr. Loupot. To give you an exact, I could not, Mr. Congressman, there were so many unknowns. For instance, you have a veterans hospital and a certain section of that hospital is occupied with equipment, and so forth, certain floor area. We don't know the cost of that, and didn't even try to estimate, but we did estimate the technician time and time put in, and the number of people he would see.

Representative Dreier. What was the disparity?

Mr. Loupot. Well, a very rough estimate, I will give you dollars, we will say the dollars that we can justify that we put our fingers on would be approximately $600 for a hearing aid unit compared, at that particular time, what we would probably be delivering for $350.

We do it for the city government and we do it here in California, as we know it, for Medi-Cal, called medicaid nationally. Medicaid operates in 18 or 20 States and that is our Medi-Cal program. We dispense the hearing aid through the Medi-Cal program for about $325 today, this very day, and most of that money, 50, 60 percent of that Medi-Cal money is Federal Government money. So the system is set up right today. All these things are set up to do it, yet a veteran lives out in Palmdale or lives in Bishop. The Government has to transport him in and keep him here and go through tests, and so forth, and then he gets a hearing aid. He lives in Bishop. Now he needs some service. The hearing aid is not going to run forever, so he needs service, and he needs help. But he has to come back into Sawtelle to get it, and that is true all over the Nation.

Representative Dreier. What kind of conclusions did you and Congressman Teague come to in that study?

Mr. Loupot. Very frankly, if I may be so candid, it wasn't with Congressman Teague so much as Mr. Meadows who was staff director of the Veterans' Affairs Committee of the House of Representatives. He quite bluntly told me, he said:

> Mr. Loupot, I want to just tell you more power to you and your investigation and your help. I have heard your story 20 times, but it might be from the druggist, from the eyeglass people or something.

He said:

> If you think you are going to whip the Veterans' Administration or convince them or stop them doing what they are doing, you are disillusioned, because that organization is larger than most countries.

And he said:

> You can never put your finger on anything, they are like Jello, you will never be able to put your finger on anything. Good luck to you, but you are going to have a heartbreaking job to try to do this.

We were doing it naturally for business purposes, but not only that. Not only that.

Representative DREIER. For the taxpayers as well?

Mr. LOUPOT. The taxpayers as well and to give better service to the people who really should be getting it.

Representative DREIER. Let me ask you, Mr. Loupot, do you believe the Senator's and my joint resolution will provide an opportunity for you to get some teeth into that?

Mr. LOUPOT. Yes, sir, to answer your questions, definitely yes. I think that Mr. Meadows' advise was well taken, because how do you beat city hall? The thing that I am hearing here this morning is no different from up and down this table. The first thing, I think if we can all get behind these two resolutions collectively, with the temperature of the administration, we should be able to do something about it. They are trying to talk about cutting budgets, cutting down, saving money. Why can't we do it?

Representative DREIER. We may have you take it to Mr. Meadows then.

Mr. LOUPOT. I think he is retired, but I would say this, we certainly did have statistics. We would like to make them available to yourself, and I will be in Washington next month and hopefully I can bring them to your office.

Representative DREIER. I am looking forward to receiving those. Thank you.

Mr. LOUPOT. Thank you.

Representative DREIER. Thank you very much, Mr. Chairman.

Mr. ZERLAUT. I would like to provide a partial answer to the question the Senator asked concerning university facilities that are not being utilized in research and teaching, and the question of what has to be done. Before stating what I believe ought to be done, I would like to provide some information concerning the interaction of my organization with a number of universities.

After we become very well known in solar device testing, we started receiving numerous requests for our help in setting up and designing, in fact, in many cases, solar test facilities for universities from all over the world. In our own particular country we have always taken the position that they might be utilized to compete with us, since it was always a research assistant or a faculty person, not a vice president or a dean of the university, that contacted us with these questions. Our response to these requests, which have been from some 20 to 30 universities, has always been that if a responsible party, dean or vice president of the university, will contact us and if he will assert that they will use the facility for research and education, DSET will provide our designs and our input without charge to that university in order to further the technology in the university sector and in the society that we depend upon in our private business. We have never had a taker, never.

Now, what can be done? I believe that one thing that can be done is to simply examine the tax laws as they relate to public sector, not-for-profit organizations. I would like to see a university's not-for-profit tax status challenged when its total work in the various departments exceeds some level and to simply lose its nontax status for education at that time. Certainly I would like to see universities forced to pay taxes on earnings that they accrue in competing with the private sector where we have paid for the right for them to compete with us. Thank you.

Senator HAYAKAWA. Thank you, Mr. Zerlaut.

I am going to call upon our next witnesses since I understand Mr. Richardson and Mr. Russell are due to take a plane as soon as possible.

Mr. RICHARDSON. We are on a bit of a tight schedule.

Senator HAYAKAWA. All right, sir. Panel III, Mr. Richardson and Mr. Russell, please come to the witness table.

Thank you gentlemen very much. Your testimony was very instructive.

Please feel free to submit material, and we may in turn submit questions to you for answers. Thank you.

Mr. Russell W. Richardson, chairman, Committee on Contracting Out, from Arlington, Va.

STATEMENT OF RUSSELL W. RICHARDSON, CHAIRMAN, COMMITTEE ON CONTRACTING OUT (COCO), ARLINGTON, VA.

Mr. RICHARDSON. Mr. Senator, ladies and gentlemen, it is a pleasure for me to be here. I am really wearing three hats.

My first one is as chairman of the Committee on Contracting Out, which speaks on the issue of contracting out for a coalition of industry associations, the great majority of whom are totally small business oriented, and who have united on this issue to the exclusion of other interests. It is a nondues paying, noncharter operation that we have had going on for about 5 or 6 years.

I also speak on behalf of Mr. Robert T. Campion, president and chief executive officer of Lear Siegler, Inc., a Santa Monica corporation. I have just recently retired and been reemployed by them as consultant to work on the Committee on Contracting Out. And third, I appear here on behalf, in an informal sense, of the chamber of commerce. The chamber of commerce does not appear formally as a member of COCO due to internal policy which prevents them from coalition situations; however, the chamber actively participates with us, shares its views with us and we agree on this issue almost entirely.

I have on the table, you will find, copies I brought with me or were sent ahead and I brought with me the chamber's position on this issue, which we subscribe to.

So I would like to say that I am going to depart just a little bit from the formal testimony that I have you here to get on to some of the key issues that I think are so deep that they have to be addressed, Mr. Chairman. First of all, I would like to remind the Congressman—but he left, so I can't remind him of anything—that one of the first private sector employees who went to work for the Government was Paul Revere. He was Boston's original DEW Line, and of course, as you know, he was also a silversmith. But in 1775 or 1776, whenever it was, he became a gunsmith, and that is what I call reliance on the private sector. It didn't start in 1955, it started a few years before that.

What we are faced with here, just to get the thing in context, and I speak now for big business, and big business is the largest employer of small business, and I speak for small business, who are the most numerous employees of big business, so we are all in the same track. There is no disagreement between us on this. What we are fighting, and what is going to cause trouble, more trouble, if it is not controlled, is the bloated, inefficient, inflexible, entrenched, virtually fireproof, and arrogant bureacracy and employee structure which has been allowed to grow to an enormous size. It is jealous of its prerogatives. It is always hungry. These gentlemen up here ahead of us were talking about automatic data processing equipment, time being sold by Government agencies all over in competition with the private sector. That is just a piece of it.

One problem, I think, is the complete library of mythology that has surrounded this thing. Much of it is engendered by the Government employees and their unions. They repeatedly say that it is cheaper to do this or that in-house. I have been unable to find anyone who has ever found a neutral source that would confirm that point. I think you, sir, have read that recent book put out by Professors Bennett and Johnson, "More Government for Half the Price, The Rule of Two," which says in effect that, if you take something from the private sector and put it in the public sector, you can figure on paying twice as much for it. Federal employees repeatedly point out, when it is to their advantage to do so, the "strike" risk. What happens if private sector people go on strike? I would say that PATCO has given us a good answer that that can happen anywhere. It is a little know fact that during the Columbia launch Boeing employees at the eastern test range were on strike. Nobody knew it. The management brought in competent people. The thing was done with no compromise of safety or efficiency. There was no delay in the program. That has happened before and will happen again.

Another charge is that Government can't control the private sector. The private sector is much easier to control. First of all, you control the dollar and the guy you are paying the dollars to controls his help. He doesn't have any problems with the Civil Service Commission. If his guy doesn't perform, he fires him. Just that simple. It happens today, not tomorrow, not 5 years from now.

Can industry move in to cover any emergency situation? During the Vietnam affair our company and many others like us, big and small, moved in and did all kinds of things, including shooting people, at people, and being shot at. There is nothing to make the civil servant any more or less a coward than a private employee.

Another charge is that the private sector is guilty of waste, fraud and abuse. You have heard all of those lovely words, always pulled out to make an impression on constituents. They are very handy. I don't know whether you have ever seen, Senator, the report dated May 7, 1981, from the GAO on the subject of fraud in government programs, how extensive it is, and how can it be controlled. I refer to a pie chart here where the GAO investigated some 77,000 cases, and I am extracting from this. They found that in 30 percent of the cases, this is of the total of 77,000, the fraud was traced to Federal Government employees acting alone. Federal contractor employees are mixed in with State and local government and grantee employees, and that whole group adds up to 3 percent. So I think fraud, waste, and abuse are not exclusively private sector problems.

The question of economy, getting back to that, there are literally, sir, 77 plus, the last time I counted, 77 GAO reports on aspects of this issue, every one of which said buy when you can from the private sector. Why don't we read them? I do not know.

I would like to give this subcommittee an example now of what I think is a large part of the problem. With all due respect, a large part of the problem resides in the Congress. I am going to tell this story. It is a real story, it is a current story.

The Department of Energy examined its security services, the watchmen and guards at Los Alamos, for a potential for contracting out under the A-76 rule and decided that it was worth going to competition out of house. They ran the competition strictly according to the rules and found they could save $3.5 million over 3 years. They proceeded then to go ahead to award a contract. They did not propose the contract to the lowest bidder, because of certain delays that the low bidder would have had in getting its security clearance, but the second guy they did pick was qualified to move in promptly. They were met by a storm of protest from the congressional represetatives of the State of New Mexico, and then they bucked the whole thing over to OMB. To make a long story a little bit short, now remember this, all of those people down there, these constituents, were complaining to their legislative respresentatives that everyone could be fired. One of the requirements of A-76 is that the first right of refusal must be given to the incumbents, so nobody was going to lose their job and DOE was going to use the $3.5 million to increase the size of the security force because they felt it had not been adequate in times gone by. So it was kicked over to OMB who carried on a dialogue with the Congress. Subsequently a rider or a paragraph was attached to the Department of Energy authorization bill which specifically forbade the use of private sector employees at Los Alamos. Not anywhere else, at Los Alamos. Yes, sir.

So I think the problem, Mr. Chairman, is that Congress is part of the problem, you know.

I know how the game is played; you vote for my dam and I will vote for your airport.

Senator HAYAKAWA. It's a deal!

Mr. RICHARDSON. It's a deal! But I think that game, I don't know whether your resolution is going to stop that or not, or have any impact on it. I think that problem has to be aired in your fraternity. I think it has to be faced up to.

Senator HAYAKAWA. It is being done, having faced A-76, the subsequent work of implementing this whole thing is going to be enormous.

Mr. RICHARDSON. Absolutely, and A-76 is imperfect, very imperfect, and I am sitting beside one of the coauthors of it. I am running a risk because I have got to ride back with him on an airplane.

But we don't think that there should be a 10-percent benefit in favor of the Government, that if they are 10-percent higher in their labor costs the work should stay in-house. I think that is tinkering with the machinery.

The reliance on the private sector has to be the primary thing, and all I can say is that this is how the private sector, the free enterprise system works. It is how we got where we are, and how we can afford to abandon it now and build up a complete, nonresponsive octopus that is grabbing more and more work as it acquires more facilities, never letting anything go, is shortsighted to say the least.

I can only tell you, Senator Hayakawa, that we in the private sector, those who understand this problem, will get involved in it, will do everything in our power to help you advance this legislation and complementary pieces of legislation that are necessary because we believe absolutely that the Republic has a real serious crisis ahead if we do not reverse this trend.

And I thank you very much for the opportunity to say so.

Senator HAYAKAWA. Thank you, Mr. Richardson, I am very grateful for your testimony.

My goodness, the problems that confront the subcommittee.

[The prepared statement of Mr. Richardson follows:]

TESTIMONY OF

RUSSELL W. RICHARDSON

CHAIRMAN, COMMITTEE ON CONTRACTING OUT

Mr. Chairman and Committee Members. On behalf of the 23 associations and councils which make up the membership of the Committee On Contracting Out (COCO), I want to thank you for allowing us to present industry's views on S.J. Res. 93 and H.J. Res. 294, joint resolutions which reaffirm the nations policy of reliance on the private sector for the procurement of goods and services.

My name is Russell W. Richardson. I am the Chairman of COCO, whose membership represents over 28 million workers, more than half of whom are in small business. These workers are engaged in technical and professional, white collared and semi-skilled tasks, both for government and the private sector, mostly in what is referred to as the Service Industry.

I am going to take a minute to read a list of the member associations and councils because I want it to be clearly stated as to who these people are, and it will not take me long. There are 23 members:

Aerospace Industries Association, American Consulting Engineers Council, American Defense Preparedness Association, American Electronics Association, Associated General Contractors of America, Association of Media Producers, Association of Data Processing Service Organizations, Building Service Contractors Association International, Conference of American Small Business Organizations, Electronic Industries Association, Helicopter Association of America, Information Industry Association, Legislative Council for Photogrammetry, Motor Vehicle Manufacturers Association of the U.S., Inc., National Association of Service Contractors, National Audio-Visual Association, Inc., National Council of Professional Services Firms, National Council of Technical Service Industries, National Security Industrial Association, National Small Business Association/National Small

Business Legislative Council, National Tool & Die Association, National Utility Contractors Association, & Textile Rental Services Association of America.

All of these people are in the private sector, that is, they work for organizations that compete in the marketplace for business. This is what we feel free enterprise is all about. Unfortunately, over the past 35 years we have developed an extensive governmental work force of millions of people at the Federal, State and Municipal levels. Now there may not be anything wrong with this, if our government really requires that many people, but what are they doing? It turns out that the government started doing a lot of things during World War II with military people, because at that time, especially overseas, the Armed Forces was the only game going. After the war, the drive was to civilianize - that meant a civil service employee. By 1955, with the additional confusion over our effort in Korea, we had the government doing so many things that the Bureau of the Budget had to announce the policy that the country relied on the private sector for the procurement of goods and services. Until then, there had been no question about it, for over 170 years.

Since 1955 there have been various changes in our procurement policy, resulting in the 1979 revision of Office of Management and Budget Circular A-76. At this time the competitive cost analysis was introduced to determine if it is cheaper for the government to do something in-house rather than in the private sector. That, Mr. Chairman, is a long way and a wrong way to go.

There is no way that the government can honestly do anything as cheaply as it can be done by its citizens. Oh, there is a lot of rhetoric, and a lot of statistics that say the government can - but how?

Does the government underpay its' employees? No! Does it have fewer supervisors than private industry? No!

Do government employees get promoted because they have reduced the size of their staff? No, they are reduced in grade if this happens.

Do government employees lose their jobs if the project they are working on is a failure? No, they transfer to another job.

Do government employees have less job stability than industry? No!

Do government employees get less fringe benefits and less pension than industry? No. Very definitely NO!

How then is it possible for the government to do something for less than private industry? They cannot - but, if you juggle the figures, it might look that way.

The one expense in industry that the government is missing is profit - the very factor that makes the whole system work. And that profit (around 3 to 8% before taxes) is more than balanced by one item in the governments package -- pensions.

How is small business affected by the governments role in business? Well, every painter, plumber, printer, programmer and parking attendant in the government is filling a job that some American citizen would like to perform with his small business. Why are any commercial or industrial tasks performed by government employees? Because we have fallen into a trap, creating a commercial and industrial structure inside our government that now competes with "contractors", the pejorative term for businessmen when they do work for the government. To be able to compete with this government business empire, a small businessman first has to be lucky enough to have the government decide to do a cost analysis. Then, if the small businessman has the lowest bid, and it is over 10% below what the government says the work can be done for in-house, he gets the job. This is a long, complicated and slippery road for many small businesses.

Examples of the Governments competition with Small Business abound in the Report of the SBA Advocacy Task Group of March 1980, so it does not serve our purpose to recount them here today.

Your Joint Resolution will go a long way toward ending government intrusion into business.

Regardless of any supposed savings by cost comparisons, we must get government out of competition with its citizens. Big business is affected but most large corporations have a good mix of commercial work. The small businesses that suffer, fail or are not created because of government performance of commercial or industrial type activities are the ones I am speaking for today. We need this business base in our economy. The millions of government employees are not to blame for their role; it is the government that created this system that must change by giving the people back their jobs.

Your joint resolution, is a vital first step in establishing a very clear principle. Our government should not compete with us in business.

COMMITTEE ON CONTRACTING OUT
(COCO)
1911 Jefferson Davis Highway
Suite 1002
Arlington, Virginia 22202
(703) 920-7640

SUBSCRIBING ASSOCIATIONS 26 AUGUST 1981

AEROSPACE INDUSTRIES ASSOCIATION
*AMERICAN CONSULTING ENGINEERS COUNCIL
AMERICAN DEFENSE PREPAREDNESS ASSOCIATION
*AMERICAN ELECTRONICS ASSOCIATION
*ASSOCIATED GENERAL CONTRACTORS OF AMERICA
*ASSOCIATION OF MEDIA PRODUCERS
*ASSOCIATION OF DATA PROCESSING SERVICE ORGANIZATIONS
*BUILDING SERVICE CONTRACTORS ASSOCIATION INTERNATIONAL
*CONFERENCE OF AMERICAN SMALL BUSINESS ORGANIZATIONS
*COUNCIL OF NATIONAL SECURITY COMPANIES, INC.
ELECTRONIC INDUSTRIES ASSOCIATION
HELICOPTER ASSOCIATION OF AMERICA
*INFORMATION INDUSTRY ASSOCIATION
*LEGISLATIVE COUNCIL FOR PHOTOGRAMMETRY
MOTOR VEHICLE MANUFACTURERS ASSOCIATION OF THE U.S., INC.
*NATIONAL ASSOCIATION OF SERVICE CONTRACTORS
*NATIONAL AUDIO-VISUAL ASSOCIATION, INC.
*NATIONAL COUNCIL OF PROFESSIONAL SERVICES FIRMS
NATIONAL COUNCIL OF TECHNICAL SERVICE INDUSTRIES
NATIONAL SECURITY INDUSTRIAL ASSOCIATION
*NATIONAL SMALL BUSINESS ASSOCIATION/
NATIONAL SMALL BUSINESS LEGISLATIVE COUNCIL
NATIONAL TOOL & DIE ASSOCIATION
*NATIONAL UTILITY CONTRACTORS ASSOCIATION
*PRINTING INDUSTRIES OF AMERICA, INC.
*TEXTILE RENTAL SERVICES ASSOCIATION OF AMERICA

* EXCLUSIVELY OR PREDOMINANTLY SMALL BUSINESS INTERESTS

LOP

1001 CONNECTICUT AVENUE, N.W.
SUITE 800 • WASHINGTON, D.C. 20036
(202) 452-1527

August 20, 1981

TO: COCO

FR: Guy A. Wilcomb
Administrator

Guy

RE: Testimony for Senator Hayakawa's Committee

Dear Russ,

I am sorry that I cannot make the August 26th meeting of COCO.

However, as you requested, I have enclosed some material on government competition with the private sector. In this case, the government has competed directly with the photogrammetric industry, which is the business of aerial photography and map-making services.

I have enclosed a letter from the president of the Association which fairly well states the problems that we are faced with, particularly where government competition with our industry is concerned.

If I can be of any further assistance, or if you need clarification on anything that I have provided you with, I would happy to talk with you.

As always, you and COCO do an exemplary job.

HWS
HOSKINS-WESTERN-SONDEREGGER, INC.
ENGINEERS • ARCHITECTS • PLANNERS
825 J ST • P.O. BOX 80358 • LINCOLN, NEBRASKA 68501 • (402) 475-4241

August 17, 1981

Congressman Douglas Bereuter
1314 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Bereuter:

As professional consultants, we often contract with, or work in cooperation with, various government agencies. In fact, federal contracts comprise a substantial percentage of our work load. Therefore, it concerns us, as private businessmen, when we observe certain activities within the federal departments which may impact upon the level of federal contracts which are potentially available to us, or other firms of a similar nature.

In this case, I am referring to firms who furnished such services as aerial photography, remote sensing, and/or topographic mapping, otherwise referred to as aerial photogrammetry. There are perhaps 400 such firms throughout the country. Most of these firms would be classed as small businesses employing anywhere from 2 to 50 employees; most with gross receipts well under 7½ million annually. Capital investment for the sophisticated equipment required to perform our services is high, and competition for contracts is keen. During the past year or so, most firms have experienced a substantial reduction in volume, not only from the cut-back in federal contracts, but also to a great extent from the uncertainty of the money market as it influences investment in new development and construction.

As you might imagine, aerial photography and mapping is used extensively in the environmental and energy related investigations. Many contracts for these services come from the various agencies within the Department of Interior. Last January 6th, the Department of Interior's Office of Survey Mining announced a contract with the Tennessee Valley Authority to provide aerial photography and other services for the OSM's inventory of the nation's abandoned coal mines to various Soil Conservation Service offices. We question why the Office of Surface Mining did not see fit to consult the private business community for these services rather than involving an independent federal agency whose primary purpose would seem to lie more with the generation and distribution of power than the aerial photography and mapping.

More recently, however, we have learned that the Department of Energy is preparing to enter the field of aerial photography. We have learned that a Cessna Citation twin turbo-prop aircraft is being modified to accommodate dual aerial photo cameras. It has been indicated to us that the aircraft will be used by the Department of Energy.

The investment in the aircraft, its modifications, and the camera systems, from our experience, will probably exceed $2 million. The annual budget to maintain a crew and the operation would undoubtedly amount to a considerable sum. There are already several aircraft of this type, and many more of somewhat less sophistication, operating within the private business community. I am sure that most of these firms would be more than happy to provide whatever aerial photography the Department of Energy has need of in the coming years. Therefore, again I am concerned as to why the federal government feels it must gear up to do this work in-house, rather than contracting to the private business community where the capacity already exists.

I cannot believe that the expertise to perform these services does not exist within the private business community. Nor can I believe that the cost to the government would be greater than it will be to gear up to do the work in-house. We are concerned not only for our livelihood through federal contracts but for the manner in which our federal tax dollars are being spent.

As president of the Legislative Council for Photogrammetry, a business association representing over 40 firms practicing photogrammetry, I feel I express the concerns of the other members as well.

Would you please look in to this matter further and tell me what your analysis of the government's objective is. It would be most appreciated.

Thank you for your time and interest.

Very truly yours,

HOSKINS-WESTERN-SONDEREGGER, INC.

By____________________
Larry J. Edwards

LJE/law
cc: ✓Mr. Guy Wilcomb

american
consulting engineers
council

1015 FIFTEENTH STREET N.W. WASHINGTON D.C. 20005
(202) 347-7474

CONTACT:
Waldon L. Baker

Contracting-Out
Commercial Or Industrial Products And Services

Scope

The acquisition of architectural and engineering services by the federal government is encompassed in OMB Circular A-76, "Policies for Acquiring Commercial and Industrial Products and Services Needed by the Government", and OMB Circular A-120, "Guidelines for the Use of Consulting Services", which are also the concern of the Comptroller General in his report of June 18, 1981, to the Congress entitled, "Civil Servants and Contract Employees: Who Should Do What for the Government?".

Policy-Objectives

OMB Circular A-76 -- Since 1955 the Executive Branch's policy has been to rely on contractors in the private sector to provide the goods and services it needs to act on the public's behalf. This policy was expressed in temporary bulletins issued as early as 1955 and was made more permanent when OMB issued Circular A-76 in 1966. The current revision of this Circular, dated March 29, 1979, (1) reaffirms the government's general policy of reliance on the private sector for goods and services, while recognizing that (2) certain functions are inherently governmental in nature and must be performed by government personnel and (3) relative cost must be given appropriate consideration in decisions between in-house performance and reliance on private commercial sources. The balanced approach in this revised circular is designed to achieve consistent policy implementation in all agencies, equitable treatment of all parties and improved economy and efficiency in providing goods and performing services needed by the government.

Agencies are required to inventory their commercial and industrial activities and establish schedules for periodic review. When appropriate, cost comparisons must be conducted of these activities (which include A-E and construction) to determine the most economical source of performance -- contracted-out or in-house. To support the increased emphasis on the relative economy of government and contract performance, a comprehensive "Cost Comparison Handbook" was issued as a supplement to Circular A-76. The handbook is to be used by all government agencies and provides detailed instructions for developing a comprehensive and valid comparison of the estimated costs to the government for each alternative and provides a more accurate basis for cost-based decisions.

In-house government operations may be authorized if justified under one of the following conditions:

1. If the agency concludes that there is no private commercial source capable of providing the product or service, or that use of a private commercial source would cause an unacceptable delay or disruption of an essential agency program; or
2. Under national defense, when (a) the government's activity is operated by military personnel and utilized or subject to deployment in a direct combat role, the activity is essential for training in those skills exclusively military in nature, or is needed to provide appropriate work

assignments, or (b) the government's activity is justified in accordance with criteria approved by the Secretary of Defense to ensure a ready and controlled source of technical competence and resources necessary to meet military contingencies; or

3. A comparative cost analysis indicates that the government can provide or is providing the product or service at a lower total cost than if it were obtained from a private commercial source.

In conducting a comparative cost analysis, both government and commercial cost figures must be based on the same scope of work and the same level of performance. This requires the preparation of a sufficiently precise work statement with performance standards that can be monitored for either mode of performance. Agencies are not to incur the delay and expense of comparing costs to justify a government commercial or industrial activity for products or services estimated to be less than $100,000 in annual operating costs. Activities below this threshold should be contracted-out unless in-house performance is otherwise justified.

Although Circular A-76 states that federal employees must perform government functions, it recognizes that agencies can obtain contractors' advice on government functions. However, it is difficult to tell where advice stops and performance begins. Similarly, OMB Circular A-120, dated April 14, 1980, defines consulting services as "those services of a purely advisory nature relating to the governmental functions", but does not specify when advice on government functions stops and performance of government functions begins.

OMB Circular A-120 -- This circular establishes policy and guidelines to be followed by executive branch agencies in determining and controlling the appropriate use of consulting services obtained from individuals and organizations. The circular supersedes OMB Bulletin 78-11 dated May 5, 1978, on the same subject; however, it contains the same definition used in Bulletin 78-11 with an expanded list of examples and designates the contracting officer as the person with final responsibility for determining whether a proposed procurement action is for consulting services. The relationship to OMB Circular A-76 is also clarified.

The circular defines consulting services as "those services of a purely advisory nature relating to the governmental functions of agency administration and management and agency program management". Agencies obtain consulting services by (1) appointing consultants to the civil service, (2) awarding a procurement contract and (3) appointing members to advisory committees.

The circular states that consulting services may be used when essential to the mission of the agency to get (1) specialized opinions or professional or technical advice which does not exist or is not available within the agency or another agency; (2) outside points of view to avoid too limited judgment on critical issues; (3) advice regarding developments in industry, university or foundation research; (4) opinions of noted experts whose national or international prestige can contribute to the success of important projects; and (5) citizen advisory participation in developing or implementing government programs that, by their nature or by statutory provision, call for such participation.

Agencies are prohibited from contracting-out inherently governmental work by Circular A-120, emphasizing that consulting services will not be used in performing work of a policy-decision-making or managerial nature, which is the direct responsibility of agency officials. The same policy was stated earlier in OMB Bulletin 78-11.

Status

Agencies are in the process of preparing their inventories, schedules and determinations as required by Circular A-76. They must complete their final submittals to the Office of Federal Procurement Policy, OMB, for review during the three-year period following the issuance of A-76 on March 29, 1979. Agencies have been granted an extended time by OMB to provide their submittals by the end of fiscal year 1982. To date, the Department of Defense has conducted more A-76 cost comparisons than any other federal agency. About 60 percent of the comparisons (190 out of 304) show that it is more economical to convert the in-house activity to contract.

In July, 1980, in response to continuing abuses in federal contracting practices, OMB gave federal agencies one month to submit plans for improving their procurements, with particular emphasis on Circular A-120 and its requirement that consulting services will not be used to perform work which is the direct responsibility of agency officials. OMB has approved all agencies' plans; however, none of the plans prescribed any specific actions to stop the practice of using consulting services to perform inherently governmental work. Most agency plans were scheduled for implementation by December, 1980; however, as of February, 1981, many agencies had not done so. Both the Department of Defense and the General Services Administration were to issue their respective Defense Acquisition and Federal Acquisition Regulations making DOD and other federal contracting officers responsible for determining whether a proposed procurement action is for consulting services. This was critical, since none of the management controls in the circular apply unless the proposed contract is first classified as a consulting service. GSA issued its regulation in August, 1980, for civilian agencies. As of February, 1981, DOD still had not issued theirs.

ACEC Position

ACEC supports the general precepts of Circular A-76 and the government's stated policy that, where private sources are available, they should be looked to first to provide the commercial or industrial goods and services needed by the government to act on the public's behalf. ACEC also supports the general guidelines of A-120 for the use of consulting services.

However, with respect to Circular A-76, we are particularly concerned that the government may perform a commercial or industrial activity solely on the basis that it can do so at a lower total cost than if it were obtained from a private commercial source and that the comparison cost figures must be based on the same scope of work and same level of performance. In our criticism of A-76 we stated that with respect to the acquisition of A-E services such policy and related procedures overlook the most important considerations -- creativity, technical competence and design quality and that these elements cannot be compared on such a total cost basis. To exclude the primary consideration of demonstrated competence and qualification for the type of professional services required at fair and reasonable prices is inconsistent with the Brooks Law.

As to Circular A-120, we stated that where A-E consulting services were needed, the circular should provide that, depending upon the type of services required, the selection and award of contracts must be consistent with Brooks Law requirements.

On August 21, 1981, ACEC submitted to OMB its in-depth review of Circulars A-76 and A-120 and included our above statements. We also recommended that necessary clarifications and modifications be made in specified sections of both circulars and offered to meet with OMB for further discussions.

Statement of the

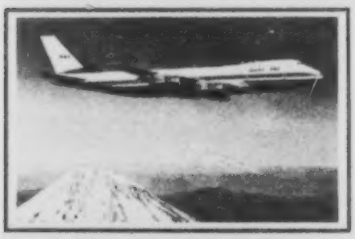
CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

ON: GOVERNMENT COMPETITION
(S.J. RES. 93, H.J. RES. 299)

TO: SUBCOMMITTEE ON ADVOCACY AND
THE FUTURE OF SMALL BUSINESS
OF THE SENATE COMMITTEE ON
SMALL BUSINESS

BY: MARK SCHULTZ

DATE: AUGUST 27, 1981



STATEMENT
on
Government Competition (S.J. Res. 93, H.J. Res. 294)
for submission to the
SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS
of the
SENATE COMMITTEE ON SMALL BUSINESS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES

by
Mark Schultz*
August 27, 1981

On behalf of the more than 158,000 members of the Chamber of Commerce of the United States, I wish to express our support for S.J. Res. 93 and H.J. Res. 294, joint resolutions which reaffirm the nation's longstanding procurement policy of government reliance on the private sector for needed goods and services.

The U.S. Chamber is the largest business federation in this country, representing more than 154,000 business firms, 2,700 chambers of commerce in this country and abroad, and 1,300 trade and professional associations.

A majority of these 154,000 business firms are small businesses. In fact, more than 97 percent of our member companies employ fewer than 500 persons, almost identical to the percentage of small businesses in the total economy. More than 60 percent of our members employ fewer than 20 persons, and more than 40% have less than 10 employees.

In view of these figures, it is fair to say that the U.S. Chamber represents the interests of American business, large and small, many of whom do business with the federal government. Accordingly, we clearly have a vital stake in eliminating government competition with the private sector in providing goods and services needed by the federal government.

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* Director, Federal Procurement Policy

Federal Procurement Policy: Reliance on the Private Sector

The U.S. Chamber recognizes the significance of any proposed changes in federal procurement policy, which now involves more than one-tenth of the federal budget. Government procurement has a major effect on the nation's businesses, their employees, government employees, and on a broader level, all American taxpayers. The policies ultimately adopted not only affect immediately the expenditure of $65 billion or more in taxpayers' money each year, but also guide the government's procurement activities for years to come.

In view of the above, it would be difficult for us to overstate the importance of close Congressional scrutiny of the total impact of any proposed changes to ensure that they do, in fact, contribute to the nation's longstanding policy of reliance on the private sector for needed goods and services.

Contracting Out vs. Government Competition

Competition with private industries by government agencies has been a source of increasing concern over the past few years.

According to recent General Accounting Office (GAO) estimates, federal employees currently perform 11,000 commercial or industrial activities that could be done by private firms. These activities cost taxpayers nearly $19 billion last year.

Consequently, private firms are finding themselves increasingly competing not only with each other, but with the government as well -- at taxpayers' expense.

For a small business already burdened by spiraling inflation, high interest rates and excessive regulations, government competition is often a crippling blow.

A 1979 Small Business Administration (SBA) Task Force Report estimated that federal in-house activities in 1977 numbered 21,130, at an annual operation cost of nearly $10 billion (a very conservative figure). According to this study, the best estimate is that at least $2 billion annually might flow directly to small business if that $10 billion were contracted-out in approximately the same proportion as other activities presently being contracted-out.

The Task Force also estimated the potential average annual savings to the taxpayer at $2.98 billion. Clearly, small business is not the only likely beneficiary if federal in-house commercial or industrial activities can be reduced.

In sum, as the business community sees it, the "business of government is to govern," not to compete with its taxpaying constituents by hiring federal employees, whose salaries and facilities are paid for by taxpaying businesses, to perform industrial or commercial activities.

The service and support industries, particularly equipment and facility maintenance, are the hardest hit by government competition. (See Appendix)

Some government agencies, having acquired surplus equipment and manpower, even sell services such as research and computer programming to other agencies.

This unnecessary growth of government competition undermines the private enterprise system and undercuts one of the nation's most valuable resources -- soundly conceived programs of scientific and technological research and development which have been vital to our economic growth, and to the welfare and security of our country.

History of Current Procurement Policy

The longstanding federal procurement policy has been, and continues to be, that the government should rely on the private sector for needed goods and services.

In 1932, the first study into the matter was made by a special committee of the House of Representatives. Numerous Congressional studies and commissions also have examined the problem in subsequent years.

However, our current procurement policy was not set forth until 1955, when the Eisenhower Administration issued a directive that the government should not provide services that put it in competition with private industry.

That policy was reaffirmed during the Johnson Administration by Circular A-76, issued by the Bureau of the Budget, predecessor of the Office of Management and Budget (OMB) (the Circular is now referred to as OMB Circular A-76).

Circular A-76 reiterated the government's general policy of reliance on the private enterprise system to supply its needs. It established the rule that goods and services were to be acquired from the private sector whenever feasible; the exception was to provide them in-house using federal employees.

Circular A-76 established new criteria for continuing or terminating in-house activity. It further provided that a government commercial or industrial activity may be authorized to provide goods or services only under certain conditions.

Advantages to Contracting Out

Circular A-76 was conceived in recognition of the major advantages of "contracting out" -- its cost-effectiveness, the flexibility it provides with regard to manpower and changing priorities, and its ability to increase technology transfers.

In most cases, the American taxpayer gets a much better deal under competitive contract than when functions are performed in-house. Procurement experts have estimated that competitive contracts can reduce costs by as much as 25 to 50 percent.

For example, according to the Office of the Secretary of Defense, for Fiscal Years '79, '80, and part of '81 DOD has conducted cost comparisons between in-house commercial activities and competitive contract performance. In 270 of these studies, contract performance was shown to be more economical and contracts were awarded, producing savings of $209 million. In the other 158 cases, and with the incentives of job competition, in-house performance was shown to be more cost-effective, reducing costs by $95 million.

Contracting out, besides being more economical, also provides government managers with a greater degree of flexibility. Contracts can be awarded, terminated, and reopened to provide needed goods and services at the lowest cost; not so with a government facility or work force. The very nature of government and bureaucracy, with the attendant civil service regulations, make reductions in force -- after a function is completed -- difficult if not impossible. While government priorities change and shift constantly, federal employees hired for one purpose remain on the government payrolls years after the project for which they were hired has been completed; not so with contracted employees.

Finally, when government research is performed by private firms, its application to civilian markets is accomplished more quickly. For example, the National Aeronautics and Space Administration's space program, which relies heavily on private sector research firms, has provided us with many useful consumer products.

It is essential that procurement policies and programs designed to further this progress in scientific knowledge and application take full advantage of the research capabilities and technical competency of private enterprise. Greater progress will be made by more fully utilizing the capabilities of private enterprise rather than by establishing or expanding government facilities in competition with them.

Implementation of Current Policy

However, as noted at the outset, over the past few years OMB Circular A-76's policy of reliance on the private sector effectively has been ignored.

Circumvention of this policy has been achieved through loose agency constructions of what is or is not a "governmental function." Under OMB Circular A-76, purely "governmental functions" are to be performed in-house. This exception to reliance on the private sector has provided agencies with "justification" for many of the activities performed by federal employees.

Threatened disruption, delays and degradation of service resulting from possible strikes by private sector unions is an often-cited reason for not contracting out important commercial or industrial functions. But, where strikes have occurred, rarely has degradation of service been experienced. Moreover, no longer can government union officials claim exemption from possible strike activity, in the wake of the threatened walk-out by postal officials and the actual strike by air traffic controllers.

Alleged abuses in the procurement system -- e.g., year-end spending, individual and organizational conflicts of interest, and sole-source contracting -- have led to calls for greater control over the so-called "beltway bandits" (i.e., consultants whose offices are located along the beltway surrounding Washington) and "invisible army of contracted employees." Unfortunately, this is a well-orchestrated movement which seeks to smear the private sector while expanding federal bureaucracy.

In fact, there is no sector of the economy with less control and accountability than government -- at all levels. Government accounting systems are oriented toward outlays and disbursements, not costs. No agency has a cost accounting system that rivals the cost accounting requirements for federal contractors. When an agency contracts for a product or service, there is a detailed accounting for all costs, in terms of the results provided. Conversely, when an agency performs a task in-house, there is control only over the number of employees and the total dollars expended -- but no control over, or accountability for, output.

Finally, critics of contracting out have made much of the large number of federal contractors and consultants. But the number of employees who may be involved in performance of federal contracts is immaterial; the fact that contract performance is more economical is the key point.

Preoccupation with the number of contract employees is irrelevant to the real issue -- economy in government. To begin with, there will never be a completely accurate account of contractors. Many are involved in providing the same product or service to private consumers; many contracts are awarded, and many others are completed each day. More significantly, most contracts are written in terms of the products or services to be provided and the cost to the government, not in terms of the number of people to be employed.

Federal Employee Union Pressure

Federal employee union pressure is most responsible for the current attitude toward contracting out.

These unions have taken a strong stance against contracts for work that could be performed by government employees. In addition, they have challenged the legality of "contract conversions", i.e., where a job previously performed by federal employees is contracted out, and have enlisted support from Members of Congress relative to agency decisions to award contracts.

The net effect of these lawsuits and protests is that agencies, understandably, are "gun shy" about awarding contracts or contract conversions.

The federal employee unions' tremendous influence has continued unabated because the business community and private sector unions have yet to exert a comparable countervailing influence.

Anti-Contracting Out Legislation

As a direct result of the federal employee unions' successful lobbying campaign, Congress over the past few years has placed moratoriums and more and more restrictions on contracting out. The Department of Defense (DOD) Appropriations Act for FY '78 contained a moratorium provision preventing contracting out of defense support functions.

In the 96th Congress, Section 502 of the DOD Authorization Act for FY '81 required detailed cost comparison studies which had to be certified by the Secretary of Defense and provided to Congress -- making

DOD's ability to convert work being done by federal employees to more cost-effective private contracts increasingly more difficult. The House version of the Act also contained a provision allowing federal employees the right to seek judicial review and relief when contract awards "adversely affected" their jobs.

Contractors also witnessed the introduction of a "federal employee relief bill" (H.R. 4717) by then-Representative Herb Harris which would have had a chilling effect on contracting out. The Harris bill was designed to prevent federal agencies from contracting out to avoid personnel ceilings. Agencies would be required to reduce their in-house personnel by the number of those contracted to perform a function. If it were found to be more cost-effective to perform a function in-house but the agency did not have the necessary personnel, the agency could request OMB to raise its personnel ceiling to accommodate the need.

Faced with the choice of losing personnel by contracting out or acquiring personnel by keeping work in-house, it is easy to predict what most agency managers would choose to do -- i.e., not contract out.

In the 97th Congress, Sections 602 and 304 of the House-passed version of FY '82 DOD Authorization (H.R. 3519) interfere with OMB Circular A-76 policies governing contracting out and conversion of DOD work to private contract. Section 602 would require military commanders to certify that a "contract conversion" would not jeopardize mobilization capabilities. Section 304 would prohibit the contracting out of an entire medical facility. Both provisions fly in the face of A-76 and would establish bad procurement precedents.

Section 10004 of this year's House budget reconciliation bill, as reported out by the House Post Office and Civil Service Committee, contained a recodification of the Harris proposal outlined above.

The Schroeder (D-Colo.) Amendment to the proposed Department of Energy (DOE) National Security authorization bill for FY '82 (H.R. 3413) would overturn a contracting out award made by DOE for security services at the Los Alamos National Laboratory in New Mexico.

Finally, the most subtle attacks on contracting out have been the constant allegations of contract abuses leveled at private consultants and a wide range of professional, research, and technical services, resulting in a variety of procurement "reform" bills.

These recent initiatives underscore the urgent need for Congressional action to reaffirm and codify the sound policy of reliance on the private sector.

Legislative Action

The Reagan Administration recently stated its position on contracting out, announcing full support for the same proven policy, i.e., reliance on the private sector whenever possible. The Administration further stated that correct and vigorous agency implementation of OMB Circular A-76 policy will give taxpayers what they deserve - economy in government.

In June, Senator S. I. Hayakawa (R-Calif.) and Representative David Dreier (R-Calif.) introduced joint resolutions to address the government competition problem.

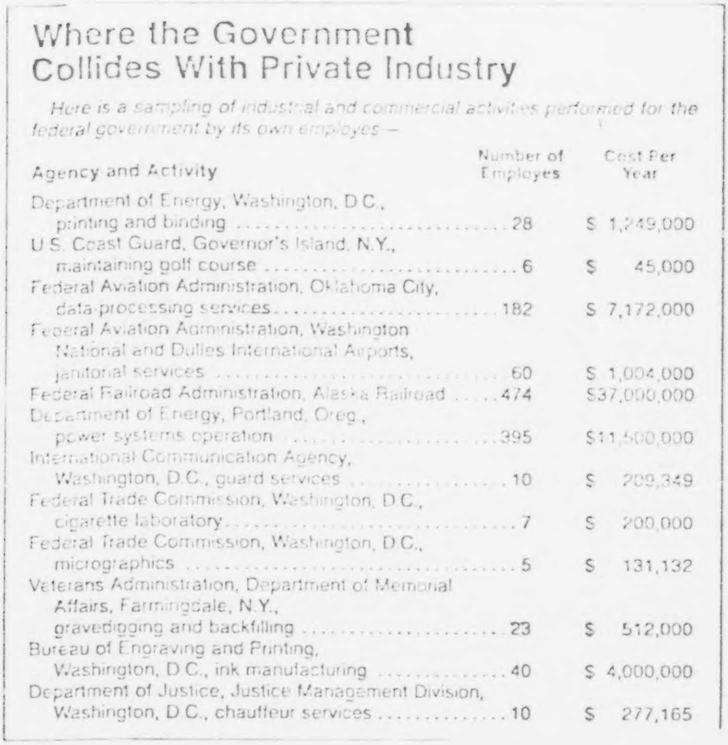
S.J. Res. 93 in the Senate and H.J. Res. 294 in the House reaffirm and codify the time-honored, but erratically observed, policy embodied in OMB Circular A-76.

The Chamber wholeheartedly supports the Hayakawa-Dreier effort to help private contractors.

The time has come to stop taking billions of dollars of work away from businesses, large and small -- those who pay a large share of America's taxes -- and to stop giving that work to federal employees whose facilities and salaries are paid for with those tax dollars.

The U.S. Chamber appreciates this opportunity to address this important issue. I will appreciate your consideration of our views, and I respectfully request that this statement be included in the hearings' record.

APPENDIX



Where the Government Collides With Private Industry

Here is a sampling of industrial and commercial activities performed for the federal government by its own employes —

Agency and Activity	Number of Employes	Cost Per Year
Department of Energy, Washington, D.C., printing and binding	28	$ 1,249,000
U.S. Coast Guard, Governor's Island, N.Y., maintaining golf course	6	$ 45,000
Federal Aviation Administration, Oklahoma City, data-processing services	182	$ 7,172,000
Federal Aviation Administration, Washington National and Dulles International Airports, janitorial services	60	$ 1,004,000
Federal Railroad Administration, Alaska Railroad	474	$37,000,000
Department of Energy, Portland, Oreg., power-systems operation	395	$11,500,000
International Communication Agency, Washington, D.C., guard services	10	$ 209,349
Federal Trade Commission, Washington, D.C., cigarette laboratory	7	$ 200,000
Federal Trade Commission, Washington, D.C., micrographics	5	$ 131,132
Veterans Administration, Department of Memorial Affairs, Farmingdale, N.Y., gravedigging and backfilling	23	$ 512,000
Bureau of Engraving and Printing, Washington, D.C., ink manufacturing	40	$ 4,000,000
Department of Justice, Justice Management Division, Washington, D.C., chauffeur services	10	$ 277,165

Source: U.S. News & World Report

Senator HAYAKAWA. Mr. William Russell, vice-president, Government Relations, RCA Service Co., Arlington, Va., representating the Electronics Industries Association.

Mr. Russell, we welcome your testimony.

STATEMENT OF WILLIAM D. RUSSELL, VICE PRESIDENT, GOVERNMENT RELATIONS, RCA SERVICE CO., ARLINGTON, VA., REPRESENTING THE ELECTRONIC INDUSTRIES ASSOCIATION

Mr. RUSSELL. Thank you very much, Mr. Chairman. It is a real privilege and pleasure for me to be here today. I think that although I am currently employed by a large business and representing an industry association that has over 380 small and large firms as members, my principal contribution to the hearing today will be from my personal experience related to this issue. That experience is unique in that I have been extensively involved with the subject both from the perspective of Government and industry, as indicated in my prepared statement. I will not read that statement, but would like to summarize it briefly and submit it for the record.

The Electronic Industries Association became very concerned over the subject of Government competition in 1967 and created a committee, which I had the pleasure of chairing, to review the problem. This committee was to look into the issues, work with Government agencies and industry representatives, and develop recommendations to reduce Government competition with the private sector.

Later, I was asked to serve with the Congressional Commission on Government Procurement, which was established in 1970 to review all aspects of Federal procurement. I spent about 18 months on full-time loan from RCA to this congressional commission serving as vice chairman of the study group which addressed the issue of Government competition with the private sector. In 1975, after the Office of Federal Procurement Policy was created by Congress in response to the major recommendation of the Procurement Commission, I was asked to come and work for OMB in that new office. I had primary staff responsibility for the policy of reliance on the private sector and for implementation of the OMB Circular that promulgated that policy.

Last year I returned to RCA, feeling that I had contributed a good part of my life to working on this issue from the Government side. I found this a singularly disillusioning and frustrating experience. Being well aware of the dimensions of the problem and some of the things that needed to be done to correct it, and then going to work in that most holy of holy offices in the executive branch, the Office of Management and Budget, with complete authority for this policy, and yet I was able to accomplish virtually nothing in 5 years.

This is just a small segment of the history of this policy, which has been expressed in a series of executive directives going back to 1955. Despite the strong support of various administrations during that time, despite all of the efforts of some very well-intentioned people in OMB, and BOB (its predecessor organization), the problem has been one that has eluded solution by the administrative approaches that have been tried in the past. The Procurement Commission, in making its report to the Congress in 1972, made approximately 150 recommendations; one of which was that this longstanding policy should be placed in law, and that there would be much more effective implementation of it by all executive agencies.

The Office of Management and Budget objected to this recommendation at the time, although strongly supporting the policy. They felt legislation was not necessary, and that the problem could be handled administratively by executive directive. I honestly think we made a sincere and conscientious effort in OMB during the 5 years that I was there to implement this policy administratively, but achieved minimum significant progress toward that goal.

I would like to comment on the dimensions of the subject. A recent GOA report indicated some 11,000 commercial and industrial activities being operated by Government agencies. While I was in OMB, we periodically solicited reports from all agencies on how many of their activities they had identified which were providing a product or service that was available from the private sector. On July 1, 1977, the total reported by the agencies was 21,130 individual activities.

At that time, the Department of Defense had identified less than 9,000 such activities. This year, DOD took a closer look at their operations and reported 14,209 such activities in DOD alone. Every report that we received, citing such numbers, are submitted by the agencies themselves—the ones that they are recognizing and reporting. However, every report is a gross understatement of the true extent of the number of activities being conducted by the Federal Government that compete with the private sector.

As a few examples, the Bureau of Indian Affairs is operating a ship which hauls cargo from the west coast of the United States to the State of Alaska. The Navy operates an electronics equipment manufacturing facility in Indianapolis, Ind., producing "black boxes" that go into the avionics system of Navy aircraft. The Navy is also manufacturing torpedos in Norfolk, Va. The Department of Commerce is the designer and holds proprietary licenses on character reading equipment that is being purchased and used by various Government agencies for optical reading of printed characters.

As many of us know, the Bureau of Mines is one of the two providers of helium gas in the world—the Soviet Government and the Bureau of Mines are the only two organizations that provide and sell helium gas. The U.S. Government has never permitted the private sector to become involved in the process of preparing, processing, and distributing helium gas—they have a monopoly on it.

Senator HAYAKAWA. It is a mysterious process?

Mr. RUSSELL. No, sir, to the best of my knowledge, they have just controlled it through Government fiat and directive all of the years. There are many, many activities in which Government is deeply involved which privide various products and services that could be handled much more efficiently by competitive private enterprise. Despite all of our efforts in OMB, and trying to be responsive to comments such as those made about the Veterans' Administration and the hearing aid problem this morning, we could do virtually nothing about them. The Veterans' Administration, on July 1, 1977, reported that they were operating 3,527 different commercial and industrial activities, with a capital investment of taxpayer funds of $457 million, and an annual operating cost of $651 million. This report, like all of the other reports we received was a gross understatement—the VA is much more extensively involved in such activities. Inflation alone would raise that 1977 figure to well over $1 billion of operating costs that you are spending for commercial and industrial activities today, but the Veterans' Administration has yet to prepare a single comparative cost analysis under OMB A-76, as revised and issued in March of 1979.

It is an extremely difficult job to try to move this great bureaucracy we have. You can issue all of the Executive orders in the world from the White House and executive directives and circulars from OMB, but they simply do not have an impact on the established organizations.

I am hopeful at this point that the joint resolutions that have been sponsored by the chairman and by Mr. Dreier in the House will provide a strong statutory base for this policy in the future. One thing we noticed in many of the GAO reports related to this issue was the conclusion that reliance on the private sector was a matter of policy and not of law. Therefore, whatever the agencies do, if it is acceptable to the executive branch under the terms of existing policy, then GAO has nothing more to say about it. If the policy were clearly expressed in a statement by the Congress, and had the force and effect of law, I would hope that it would get more attention from the agencies as well as more attention from watchdog organizations such as the General Accounting Office.

This is a subject, as I am sure you can tell, that I can talk about all day. I will stop at this point, and I would be pleased to respond to any questions you might have.

Senator HAYAKAWA. Thank you very much, Mr. Russell. You say after 5 years you felt that you had accomplished nothing at OMB in the direction you wanted to go?

Mr. RUSSELL. Yes, sir.

Senator HAYAKAWA. Do you think that the new administration and new direction in the OMB, is going to make any difference, or is it too, a huge bureaucracy, like other bureaucracies in other agencies, to go on forever like Old Man River?

Mr. RUSSELL. I am afraid the latter observation is more accurate, sir, despite the very best of intentions by this administration and the very best of intentions of the officials that have been appointed to head up the various departments and agencies of Government. I have seen no progress, and I have watched very closely for some, since this administration took office early this year.

Senator HAYAKAWA. If in one area alone, whether it is VA or any other area, you have a dramatic contract conversion breakthrough accompanied by sufficient publicity and controversy and ultimate victory, would that one victory start unfreezing a number of other vested interests in the present system?

Mr. RUSSELL. No, sir, I don't think so. We have had some very outstanding examples, primarily the Department of Defense where comparative cost analyses under the OMB Circular resulted in conversion of activities from in-house to private sector contracts with savings as high as 50 percent. These cases were widely publicized; and the result was that the House Armed Services Committee created new restrictions to make it far more difficult for DOD to convert anything from in-house to contract.

Senator HAYAKAWA. So much of what you say points to a very discouraging conclusion with respect to the joint resolution introduced by Congressman Drier and myself. Is this an exercise in futility?

Mr. RUSSELL. I think we have to be eternally optimistic, Mr. Chairman, that is the only thing that keeps us all going. What encourages me about your initiative is that never before have we had an effective statutory base for this policy; it could make a difference.

Senator HAYAKAWA. I see.

Mr. RUSSELL. We have been dealing with executive directives, and I am hopeful that passage of your resolution, which will establish a strong congressional endorsement for the policy, would provide much more support for implementation efforts from the executive branch, and hopefully less interference from Members of Congress looking at narrow parochial issues when their constituencies try to frustrate that policy in individual cases. If we have congressional approval supporting the policy, it should help.

Senator HAYAKAWA. I am going to stop at this point on a slightly optimistic note before I get too discouraged. I know both of you gentlemen are under time pressures. I thank you both, and if there are other questions, I will be writing to you about them and hopefully will receive replies.

Thank you.

Mr. RUSSELL. I appreciate the opportunity very much. Thank you.

Senator HAYAKAWA. Thank you.

[The prepared statement of Mr. Russell follows:]

STATEMENT OF

WILLIAM D. RUSSELL
VICE PRESIDENT, GOVERNMENT RELATIONS
RCA SERVICE COMPANY

ON BEHALF OF

THE ELECTRONIC INDUSTRIES ASSOCIATION

BEFORE A HEARING BY

THE SUBCOMMITTEE ON ADVOCACY AND THE FUTURE
OF SMALL BUSINESS
SENATE COMMITTEE ON SMALL BUSINESS

IN

LOS ANGELES, CALIFORNIA

ON

AUGUST 27, 1981

Mr. Chairman, I am very pleased to have the opportunity to appear before your Subcommittee today and offer my comments on a subject that is very near and dear to me--Government competition with private business. I have had the unique experience of close association with this issue from both the Industry and Government perspectives, and consider it one of the most persistent and pervasive problems faced by business today. According to the best information available, which I consider to be a gross understatement, the Federal Government operates more than 21,000 commercial and industrial activities, with a capital investment of $13 billion and an annual operating cost of $9 billion. The General Accounting Office recently estimated the annual cost to be as high as $19 billion a year, involving 400,000 employees, almost one fourth of the Federal civilian work force!

The Electronic Industries Association (EIA) represents 380 large and small firms engaged in the manufacture of communications and electronics equipment and providing a wide variety of services to commercial and Government customers. In 1967, EIA became concerned over the extensive Government competition, and established a Service Contracts Committee to review the problem and present the Industry concerns to Government policy makers. As the first chairman of that committee, I worked closely with Industry representatives and Government agencies to identify the extent of the problem and to develop recommendations for more effective implementation of the Government's stated policy of reliance on the private sector for goods and services.

Congress established the Commission on Government Procurement in 1970 to review all aspects of Federal procurement. I served as vice-chairman of the study group that investigated the Government competition issue and developed the Commission's recommendations on this subject. The Commission recommended that the policy of reliance on the private sector, which had existed in executive directives since 1955, be enacted into law and more effectively implemented by all Federal agencies.

In 1974, Congress created the Office of Federal Procurement Policy in the Office of Management and Budget (OMB) to implement the recommendations of the Procurement Commission and provide leadership in developing policy on procurement-related issues. I joined this new office, with principal staff responsibility for the policy of reliance on the private sector and the OMB directive (Circular A-76) which promulgated that policy. For over five years, I worked vigorously to bring executive branch practice into compliance with stated policy.

OMB consistently took the position that legislation was not only unnecessary, but would be counterproductive, and that the policy could be best implemented by executive directives and administrative action. Following that approach, we proceeded to apply all possible pressure to agencies to comply with the existing OMB Circular, but met massive bureaucratic opposition. That resistance, plus parochial Congressional interference and other political considerations, frustrated all efforts, and a decision was made to revise the Circular. The extensive review of the OMB directive, solicitation and consideration of comments from all interested parties, and internal coordination necessary for such a revision, took two years, during which there was no implementation effort at all. The revised Circular A-76, which was issued in 1979, reflected a compromise between the conflicting interests and was considered to be more acceptable and implementable than the stronger policy statement in its predecessor.

That assumption proved invalid, however, because the revised Circular, even with added "balance", a sound economic rationale, and new considerations for affected

Federal employees, was still threatening to established empires and response has been minimal. Agencies failed to meet deadlines specified for issuing implementing regulations and publishing schedules for review of in-house activities. Individual Members of Congress with large and vocal Federal employee constituencies continued to insert provisions in authorization and appropriation bills designed to prohibit or discourage any contracting for functions performed by Federal employees. The agency that has made the greatest effort and clearly demonstrated the value of contracting out--the Department of Defense--has been the target of the greatest restrictions in its authorizing legislation

During a two year period, DOD conducted cost studies of 220 in-house commercial and industrial activities, comparing Government costs to contract bids. In 135 studies, private performance showed enough cost savings (10% of Government personnel costs), and 135 contracts were awarded to large and small business firms to perform the work. These conversions produced documented savings of $96.3 million, reduced Federal civilian employment by 4440, and released 1710 military personnel for military duties. There are at least 14,000 more commercial and industrial activities in DOD, and more than that number in the civil agencies, but progress toward scheduling and conducting cost studies has been ridiculously slow.

Despite the strong support of the present Administration, and the best of intentions by the appointed agency heads, this program is being disrupted by a small segment of the population, Federal employees, who hold key positions in Government and have a disproportionate influence on their elected representatives. Despite the past reluctance of OMB to consider a legislative solution to this dilemma, on June 24, 1981, Donald Sowle, Administrator for Federal Procurement Policy, testified before this Subcommittee in support of Senate Joint Resolution 93. This resolution, which the Chairman introduced on June 22, 1981, would give the Government's long-standing policy of reliance on the private sector the force and effect of law. Since over twenty-five years of executive directives have failed to have any significant impact on bureaucratic practices, it certainly seems to be time to try an alternative approach.

The Electronic Industries Association strongly supports your resolution, and has distributed it to all its 580 member companies. You may rest assured that whatever support we can provide for S.J. Res. 93 and its House counterpart, H.J. Res. 294, will be forthcoming.

With that point, I will close my formal statement and be pleased to respond to any questions that you might like to ask.

Senator HAYAKAWA. May we call now upon panel II, Mr. Bill McCalmont, Los Angeles Chamber of Commerce, and Mr. William H. Prouty, executive director, The United Federation of Small Business, La Mesa, Calif.

Am I pronouncing your names correctly, Mr. McCalmont and Mr. Prouty?

Mr. McCALMONT. Yes.

Mr. PROUTY. Yes.

Senator HAYAKAWA. Good. Mr. McCalmont, we are ready to receive your testimony at this point.

STATEMENT OF WILLIAM C. McCALMONT, LOS ANGELES AREA CHAMBER OF COMMERCE, LOS ANGELES, CALIF.

Mr. McCALMONT. Yes, sir, Mr. Senator. I am William C. McCalmont, manager, growing companies program of the Los Angeles Chamber of Commerce. I speak in behalf of the more than 4,000 members of the chamber, which is the largest business organization in Western America. A great majority of our members are small businesses. In view of this fact, it is appropriate to say that we speak not only for large business, but also small business.

Our chamber enthusiastically unites and wishes to support your legislation that you are putting forth, a policy that is nost necessary at this time, perhaps a greater necessity at this time than at any other time in history.

We are definitely concerned about Federal procurement policies which currently involve more than one-tenth of the Federal budget. This area in our estimation demands for the sake of the small business person and the American taxpayer a reexamination and a very close scrutiny.

Due to varied interpretation and shifts in emphasis over the years, this policy has meandered far afield from its original intent. We believe that the most formidable competitor to small business today is not the neighboring business down the street, but, the Federal Government. The figures, though conservative, are staggering. More than $2 billion worth of business annually going to the Federal Government could very well go to small businesses throughout the Nation.

Private firms are finding themselves today competing not only with each other, but with the Government, and at taxpayers' expense. For a small business burdened by spiraling inflation, high interest rates and excessive regulations, Government competition is often a crippling blow. The Los Angeles Chamber of Commerce is of the firm conviction that the business of Government is to govern and not compete with its taxpaying constituents by hiring Federal employees, whose salaries and facilities are paid for by taxpaying businesses to perform industrial or commercial activities.

The Los Angeles Chamber of Commerce believes that the Federal Government should not be the sole authority as to what area, Government or private sector, the most reasonable cost can be derived. It is most difficult to structure cost comparisons with private firms and then act as a fair judge of these competitions. I'd say off the record that I have here, it is a guideline that the Government follows as sole determining judge, that it is too narrow. They do not consider quality, reliability, incentive to take a risk, innovation, cut costs, adapt new techniques.

If we were to go back and look at all of the decisions that have been made, I'm quite sure that we would find that the small businessman has come out on the short end. I believe the Government should ask the question: Can the Government do their laundry, make their movie, print, laboratory work, retail, transportation, mail and food more reasonable than the private sector. It is the situation where the Federal Government is the sole judge in its own competitive activity that has led to varied interpretations and shifts in emphasis of this policy over the years.

We know, for example, studies have been made that where it costs the Government $11.4 billion to do for themselves, and the private sector can do for $5.6 billion.

Another area that the chamber is concerned about is lack of uniformity in Government procurement. It is revealed in a Small Business Administration study entitled "Government Competition a Threat to Small Business," that a product or service that one Government agency would contract out, another agency would provide itself internally. The procedures to enforce Government procurement compliance with rules already in effect simply do not exist.

Recently this Nation began to gradually slip from the true objectives of the free enterprise system. We began to lose our dynamic boldness, that ingenuity, as a British journalist put it, "The once rambunctious American spirit of adventure is today being paralyzed by the desire to build a risk-free society." Many of the great economic verities that made this Nation great have become clouded and in need of a clear restatement of its original intent.

The Los Angeles Area Chamber of Commerce believes that the time has come for the Congress of the United States to clearly restate, reaffirm, and codify the time-honored, but erratically followed, policy embodied in OMB Circular A-76.

We wholeheartedly support the Hayakawa-Dreier effort to clarify the Government's relation to private enterprise and return to its original intent, and that is to govern.

Thank you, Mr. Senator, for allowing us to present our concerns and our thoughts at this hearing.

Senator HAYAKAWA. Thank you very much, Mr. McCalmont. I will save my questions until later when I have heard from all of you.

[The prepared statement of Mr. McCalmont follows:]

LOS ANGELES AREA CHAMBER OF COMMERCE
404 SOUTH BIXEL STREET · LOS ANGELES, CALIFORNIA 90017 · (213) 629-0711

THE SENATE SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS HEARINGS ON THE ISSUE OF GOVERNMENT COMPETITION WITH SMALL BUSINESS.

TESTIMONY OF WILLIAM C. McCALMONT
FOR THE LOS ANGELES AREA CHAMBER
OF COMMERCE - 27 AUGUST, 1981

CUSTOMS COURTROOM OF THE FEDERAL BUILDING,
LOS ANGELES, CALIFORNIA

Good Morning. I am William C. McCalmont, Manager, Growing Companies Program of the Los Angeles Area Chamber of Commerce. I speak in behalf of the more than 4,000 members of the Los Angeles Area Chamber of Commerce. The Los Angeles Chamber of Commerce is the largest business organization in Western America. A great majority of our members are small businesses. In view of this fact it is appropriate to say that the Los Angeles Chamber of Commerce represents the business interests of Southern California, large and small.

The Los Angeles Chamber enthusiastically unites with Senator Hayakawa, Congressman David Drier, the General Accounting Office, the Office of Management and Budget in reaffirming the policy of the Government of the United States to rely on competitive private industry to supply the products and services it needs whenever competitive industry prices are available.

We are concerned about Federal procurement policies which currently involve more than one tenth of the Federal budget. This area in our estimation demands for the sake of the small business person and the American tax payer, close scrutiny.

Due to varied interpretations and shifts in emphasis over the years, this policy has meandered far afield from its original intention. The Los Angeles Chamber of Commerce believes that the most formidable competitor to small business today, is not the neighboring business down the street, but, the Federal Government. The figures are staggering. More than $2 billion dollars worth of business annually going to the Federal Government could be contracted out to the nations smaller firms with the proper administration of this policy.

Private firms are finding themselves, today, competing not only with each other, but with the government as well, and at taxpayers expense. For a small business burdened by spiraling inflation, high interest rates and excessive regulations, government competition is often a crippling blow.

The Los Angeles Chamber of Commerce is not of the belief that the enforcement of this policy would increase the nation's unemployment figure. We feel that the displaced government workers could secure jobs with the private firms that take over their duties or free them to do what government does best - to govern.

The Los Angeles Chamber is of the firm conviction that the business of government is to govern and not to compete with its taxpaying constituents by hiring federal employees, whose salaries and facilities are paid for by taxpaying businesses to perform industrial or commercial activities.

The Los Angeles Chamber of Commerce believes that the Federal Government should not be the sole authority as to what area, government or private sector, the most reasonable cost is located. It is most difficult to structure cost comparisons with private firms and then act as a fair judge of these competitions.

It is this situation where the Federal Government is the sole judge in its own competitive activity that has led to varied interpretations and shifts in emphasis of this policy over the years.

Another area of the Chamber's concern is the lack of uniformity in Government procurement. It was revealed in a small business administration study entitled, "Government Competition a Threat to Small Business", that a product or service that one government agency would contract out, another agency would provide for itself internally. The procedures to enforce Government Procurement compliance with rules already in effect simply do not exist.

This 1979 study by the SBA task force estimated that federal in-house activities in 1977 numbered 21,130, at an annual operation cost of almost $10 billion dollars. According to this study, the best estimate is that at least $2 billion dollars annually might flow directly to small business if the policy reinstated in S.J. Res. 93 and H.J. Res. 294 were enforced to the letter of its original intent.

Recently this nation began to gradually slip from the true objectives of the free enterprise system. We began to lose our dynamic boldness and ingenuity. As a British journalist put it, "the once rambunctious American spirit of adventure is today being paralyzed by the desire to build a free risk society." Many of the great economic verities that made this nation great have become clouded and in need of a clear restatement of truth.

The Los Angeles Area Chamber of Commerce believes that the time has come for the Congress of the United States to clearly restate and reaffirm and codify the time honored, but erratically followed, policy embodied in OMB Circular A-76.

The Los Angeles Chamber of Commerce whole-heartedly supports the Hayakawa-Dreier effort to clarify the government's relation to private enterprise.

Thank you, gentlemen, for allowing us to be represented at this hearing and to share our concerns and analysis on this complex but most vital subject.

Senator HAYAKAWA. Mr. Prouty, would you like to present your testimony now?

STATEMENT OF WILLIAM H. PROUTY, EXECUTIVE DIRECTOR, UNITED FEDERATION OF SMALL BUSINESS, LA MESA, CALIF.

Mr. PROUTY. Yes. Thank you, Senator.

I am pleased to be here today to participate in this hearing on Government competition with small business. I wish to personally thank you on behalf of the members of the United Federation of Small Business, Senator, for your deep concern about this matter, and especially for your sponsorship along with Congressman Dreier of the joint resolution which reaffirms that it is the basic policy of the Federal Government to rely on the competitive private enterprise system to provide needed goods and services.

It is truly unfortunate that you were compelled to introduce this resolution, since 26 years ago the Eisenhower administration articulated the position that the Government should not provide services that put it in competition with private industry. Then, during the Johnson administration, the Bureau of the Budget issued Circular A-76, which reiterated the same general policy.

Today, even the General Accounting Office has restated this policy, there has been precious little attention paid to it. In fact, the GAO contends that Federal agencies right now are small business' biggest competitor for Government contracts, and other services. According to their most recent report, the GAO cited 400,000 Federal workers that are dedicated to providing those services at a cost to the taxpayers of this country of over $19 million annually.

It is the position of the United Federation of Small Business that almost all of these activities can be done more efficiently and less expensively by small business contractors. In fact, GAO states that over $3.6 billion of savings could be generated by the use of small business contractors instead of current Federal employees.

This morning, it has been very clearly defined, another key concern of ours, and that is the matter of awarding millions and possibly billions of dollars in contracts to nonprofit organizations instead of available for-profit businesses. This is tremendously distressing. When you see that in 1980 11 percent of all Federal research and development funds went to universities, over $23 billion, and of this, 89 percent of the money was used for projects competing directly with existing private firms. Federal agencies such as the National Science Foundation, the National Foundation for the Arts, and the National Foundation for the Humanities should be required to seek out private firms rather than simply using their traditional university clients when awarding research contracts.

There are many talented private research firms that should be sharing this type of work. It should be the obligation of the Federal Government to allow private firms the opportunity of such participation. Yet, very few private companies receive the advance information necessary on which to prepare an adequate bid, and by that alone have been systematically eliminated from the competitive process.

Since this hearing is on the matter of "Government competition with small business," I cannot help but mention the fact that both local government and State governments are equally guilty in this matter. Recently in San Diego, a private paramedic company called MEDEVAC, Incorporated, had been providing medevac—I mean paramedic services to the city of over 800,000 and other cities throughout California, was directly competed against by the fire department of that city and almost convinced the city council they could provide those services less expensively to the tune of $1 million. A very indepth cost study showed in fact that their true cost of delivery would have exceeded the MEDEVAC delivery by $2.4 million. So it is not just the Federal Government that small business is being effectively competed with.

While printing, laundry, security services, gardening, and other contracts are important, the most significant area of competition between the Federal Government and small business has not yet been addressed.

The most significant problem facing the 14 million small business firms in the United States today is the lack of capital for growth, or, in many instances, just survival. The 1,600 delegates to last year's White House Conference on Small Business and delegates to similar conferences in States throughout the Nation have repeatedly indicated that their highest priorities are resolution of capital formation and retention issues. During the last quarter the Federal Government invaded the private and public money markets to the tune of almost $35 billion. When you combine this borrowing impact with that of the major corporations of this Nation, it is easy to see why there are only a few capital crumbs left for the capital-starved small business community, particularly those non-high-technology industries that have not had quite as much publicity as the high-technology research companies have been given. The failure of Congress to pass meaningful legislation to spur savings and investment borders on almost criminal neglect. Issues like the small business participating debenture, exclusion from income of a reasonable level of interest or dividends for risk takers, capital gains rollover for small business development and expenses, reduction of the existing capital gains tax levies, are all designed to encourage those individuals and institutions with large pools of capital to receive a reasonable reward for the risk they take in fostering the growth of the American economic system. Investment means jobs, and jobs mean income, and income means taxes. After all, if only one-half of the small business firms in the Nation hired just one human being, unemployment would virtually cease to exist. That's right. Over 7 million new jobs for people who only want the opportunity to contribute to and participate in the American dream.

I would sincerely hope that these hearings, that your resolution and that of Congressman Dreier, would help spur congressional action, meaningful congressional action, and also it would encourage State legislatures, county boards of supervisors and city councils, so that government, at all levels, will substantially reduce its competition with America's real hope for economic revitalization—the men and women of the Nation's 14 million small firms who "put it on the line" each and every day.

Thank you for the opportunity to be here and we enjoyed the opportunity to participate.

Senator HAYAKAWA. Thank you. Mr. Prouty, your testimony is deeply felt and carries a lot of weight. We are grateful for it.

[The prepared statement of Mr. Prouty follows:]

United Federation of Small Business

National Headquarters:
4917 Palm Avenue, Suite A
P.O.Box 936
La Mesa, California 92041

(714) 464-0748

Regional Office
2344 Hurley Way
Sacramento, California 95825

(916) 925-2356

FOR RELEASE ON DELIVERY
11:00 a.m.
Thursday, August 27, 1981

STATEMENT OF WILLIAM H. PROUTY
EXECUTIVE DIRECTOR
UNITED FEDERATION OF SMALL BUSINESS

BEFORE THE
SUBCOMMITTEE ON THE ADVOCACY AND FUTURE
OF SMALL BUSINESS

ON

GOVERNMENT COMPETITION WITH SMALL BUSINESS

Mr. Chairman:

I am pleased to be here today to participate in this hearing on government competition with small business. I wish to thank Senator Hayakawa for his deep concern about this matter, and especially for his sponsorship of Senate Joint Resolution 93, which reaffirms that it is the basic policy of the federal government to rely on the competitive private enterprise system to provide needed goods and services.

It is unfortunate that the Senator was compelled to introduce this Resolution, since twenty-six years ago, the Eisenhower Administration articulated the position that the government should not provide services that put it in competition with private industry. Then, during the Johnson

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Administration, the Bureau of the Budget issued Circular A-76, which reiterated this same general policy.

Today, even the General Accounting Office has re-stated this policy, but there has been precious little attention paid to it. In fact, the G.A.O. contends that federal agencies are small business' biggest competitor for government contracts. According to their most recent report, the G.A.O. cited 400,000 federal workers who now operate some 11,000 "commercial and industrial activities," costing over $19 billion annually.

It is the position of the United Federation of Small Business that most of these activities can be done more efficiently and less expensively by small business contractors. According to G.A.O. studies, over $3.6 billion of savings can be generated by the use of private small business contractors instead of current federal employees.

I would like to turn my attention to another matter concerning government competition with small business. The matter of awarding millions of dollars in contracts to non-profit organizations, instead of available for-profit businesses, is most distressing. For example, in 1980, 11 percent of all federal research and development funds went to universities, a total of $23 billion. Of this, 89 percent of the money was used for projects competing directly with private firms. Federal agencies such as the National Science Foundation, the National Foundation for the Arts, and the National Foundation for the Humanities should be required to seek out private firms rather than simply using university clients when awarding research contracts.

There are many talented private research firms that should be sharing this type of work. It should be an obligation of the federal government to allow private firms the opportunity for such participation. Yet, very few private companies receive advance information on contract bidding, and--therefore--are systematically eliminated.

Since this hearing is on the matter of "government competition with small business," I cannot help but mention an example of local government and its efforts to, quite simply, drive a small business out of business. In San Diego, a paramedic company called MEDEVAC has been providing outstanding services to this city of 800,000 and scores of other communities throughout California. The San Diego Fire Department attempted to replace MEDEVAC in this capacity, and the San Diego City Council was about to go along with the proposal--when the United Federation of Small Business and others helped convince the City Council that such an action was the grossest example of government competition with small business.

While printing, laundry, security services, gardening and other contracts are important, the most significant area of competition between the federal government and small business has not yet been addressed in these hearings.

The most significant problem facing the 14 million small business firms in the United States is the lack of capital for growth, or in many instances, just survival. The 1,600 delegates to last year's White House Conference on Small Business and delegates to similar conferences in states throughout the nation, have repeatedly indicated that their highest priorities are resolution of capital formation and retention issues. During the last quarter the federal government invaded the private and public money markets to the tune of almost $35 billion. When you combine this borrowing impact with that of the major corporations of this nation, it is easy to see why there are only a few capital crumbs left for the capital-starved small business community. The failure of Congress to pass meaningful legislation to spur savings and investment borders on almost criminal neglect. Issues like the small business participating debenture, exclusion from income of a reasonable level of interest or dividends, capital gains rollover for small business development, and reduction in the capital gains tax levies, are all designed to encourage those individuals and institutions with large pools of capital to receive a reasonable reward for the risk they take in fostering the growth of the American economic system. Investment means jobs and jobs mean income, and income means taxes. After all, if only one-half of the small business firms in the nation hired just one human being, unemployment would virtually cease to exist. That's right. Over seven million new jobs for people who only want the opportunity to contribute to and participate in the American dream.

I would hope that these hearings, and Senate Joint Resolution 93, will spur meaningful Congressional action, and action in our State Legislatures, by County Boards of Supervisors, and City Councils, so that government--at all levels--will substantially reduce its competition with America's real hope for economic revitalization--the men and women of the nation's 14 million small firms who "put it on the line" each and every day. Thank you.

Senator HAYAKAWA. Let's hear next from Mr. James "Mike" McKevitt, National Federation of Independent Business, NFIB, Washington, D.C. It is a pleasure to have you here today.

STATEMENT OF JAMES D. "MIKE" McKEVITT, DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C.

Mr. McKEVITT. I think we brought the Washington weather out here with us. For your information, it is a cool 82 degrees in Washington today. An unbelievable August, I guess, in both cities.

I would like to submit my statement for the record, Mr. Chairman, and make a few remarks from it.

Government competition is of vital interest to our membership, as evinced by their response to a poll we took in March of 1980. We asked whether the Federal Government should be required to contract out to private sector for goods and services whenever and wherever it is cost-effective, and 67 percent of responding members voted favorably.

Our members' concern over this issue in part arises from their belief that Government should not be in the business of business. But the concern also comes from personal experience:

One of our members from California in the tire retreading business who lost his contract with the National guard as a result of their opening their own retreading plant in Utah. A member in Kansas who writes of USDA county agents undercutting small retailers by selling seeds, chemicals, and so forth, at cost. One of our members in Colorado who complains about HMO's setting up their own pharmacies, optical centers, and so forth. One member in Indiana trying to compete with the Department of Energy in selling insulation. Members in North Carolina and Arizona who tell of the PX competing with small retailers, selling stereos, washing machines, and so forth, at drastically reduced prices. Now getting into credit cards.

A member in Indiana who complains about students in the university operating their own grocery store. A member in Ohio in competition with HUD. The member rents tools to people—HUD provides them for nothing.

Government does compete with the private sector, and on a vast scale. A recent study by the General Accounting Office (GAO) indicates that: "An estimated 400,000 Federal employees are currently operating over 11,000 commercial or industrial activities at an estimated cost approaching $19 billion annually." In other words, nearly one of every four employees of the executive branch civilian work force is currently engaged in activities which are clearly not of a policy, decisionmaking, or managerial nature, in direct competition with employees performing essentially the same activities in the private, for-profit sector. Yet a significant proportion of these activities cannot even be justified on a cost-savings basis in accordance with the dictates of Circular A-76.

The problem of direct Government competition is excess enough, but there is another aspect which is often overlooked, but merits equally serious consideration, that is, indirect competition. Indirect competition primarily exists in two forms: The awarding of Federal contracts and grants to nonprofit entities; and Federal grants to

State and local agencies, either through general revenue sharing or targeted funds, which are used to develop or sustain various in-house commercial and industrial activities on the State and local level.

The increasing role of nonprofits in activities which have always been performed by private enterprise is a matter of deep concern to many businesses, and particularly small businesses which cannot hope to compete on an equal basis against the subsidized resources and tax-favored status of the nonprofits. Clearly there exists in the Federal procurement process an inherent bias towards nonprofits.

Equally puzzling is the decided preference given to universities in the awarding of Federal contracts and grants. For example, universities have been favored in the awarding of billions of dollars for research. Yet all the evidence indicates that small business, while receiving less than 5 percent of all Federal R. & D. dollars, has contributed almost one-half of major U.S. innovations during 1953 to 1973. In recent years the academic would has been the primary beneficiary of a wide array of Government-sponsored assistance programs, the bulk of the money for which often supports overhead expenses rather than being spent to assist clients as intended. Even more disturbing is the use of grant moneys for such things as construction of motels to be owned and operated by universities, particularly when motels are already present in the area.

We have defined the problem in our testimony, but what factors are essential to the solution? One obvious factor is the role that the Congress chooses to play in the debate over Government competition. Historically, Congress has deferred to the executive branch as to the determination of national policy on the subject of private sector reliance for goods and services needed by the government. For example, Congress has never passed a resolution or law to mandate reliance on the private sector. Nevertheless, there has been precedent-setting activity in this area, and we refer to the history of this so far as the 83rd Congress, and other matters that come up on page 9 of our testimony.

Further, reliance on the private sector would realize significant cost savings to the Federal Government.

Bennett and Johnson's book, the citation set forth here in our testimony, includes numerous instances of cost comparisons between the private and public sectors for a wide range of activities. The inescapable conclusion is that the private sector is significantly more efficient in delivering needed goods and services than is the public sector. As one economist stated, such findings lead to the suggestion of a "Bureaucratic rule of Two: Removal of an activity from the private to the public sector will double its unit cost of production."

A strong commitment to private sector reliance for the provision of needed goods and services is essential. Therefore, NFIB wholeheartedly supports S.J. Res. 93, to clarify and reaffirm, by legislative mandate, this basic policy of reliance on the competitive private enterprise system. We applaud the chairman for his introduction of this resolution and promise NFIB's assistance in achieving enactment, for we believe, as GAO has stated: "Without legislation, the executive branch can continue to unilaterally shift policy emphasis. Congressional action can preclude such unilateral shifts and establish a stable national policy. Such action would provide the necessary incentive for Federal agencies to implement the policy with assurance that it could not be changed again without congressional approval."

Senator HAYAKAWA. Thank you very much, Mr. McKevitt.

[The prepared statement of Mr. McKevitt follows:]

NFIB National Federation of
Independent Business

STATEMENT OF

JAMES D. "MIKE" MCKEVITT

DIRECTOR OF FEDERAL LEGISLATION
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before:	The Subcommittee on Advocacy and the Future of Small Business of the Senate Committee on Small Business
Subject:	Government Competition
Date:	August 27, 1981

Mr. Chairman, on behalf of the National Federation of Independent Business (NFIB), which represents in excess of a half million small and independent businesses across the nation, I am pleased to appear before you today to discuss the issue of government competition with the private sector.

Government competition is of vital interest to our membership, as evinced by their response to a poll we took in March of 1980. Asked whether the Federal government should be required to contract out to the private sector for goods and services whenever and wherever it is cost effective, 67% of responding members voted favorably.

Our members' concern over this issue in part arises from their belief that government should not be in the business of business. But the concern also comes from personal experience:

-- a member from California in the tire retreading business who lost his contract with the National Guard as a result of their opening their own retreading plant in Utah.

-- a member in Kansas who writes of USDA county agents undercutting small retailers by selling seeds, chemicals, etc. at cost.

-- a member in Colorado who complains about HMO's setting up their own pharmacies, optical centers, etc.

-- a member in Indiana trying to compete with the Department of Energy in selling insulation.

-- members in North Carolina and Arizona who tells of the PX competing with small retailers, selling stereos, washing machines, etc. at drastically reduced prices.

-- a member in Indiana who complains about students in the university operating their own grocery stores.

--a member in Ohio who is in competition with HUD. The member rents tools to people -- HUD provides them for free.

Concern over government competition with the private sector is not a new phenomenon. In fact, as early as 1952, President Eisenhower championed the principle of government reliance on the for-profit private sector for goods and services needed by the government, the basic message being that no Federal project would be undertaken by government employees which the private, for-profit sector could effect. Formal adoption of the principle as Federal policy was achieved in the Bureau of the Budget (BOB) Bulletin No. 55-4, issued in January 1955, which included the following statement:

> It is the general policy of the Administration that the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.[1]

BOB Bulletin No. 55-4 is remarkable in its categorical commitment to reliance on private enterprise. In fact, the Bulletin went on to state that cost comparisons were not to be a factor except in such instances where a product or service could not be purchased on a competitive basis or at a reasonable price. What is most interesting are the three reasons cited for discounting consideration of government vs. private sector costs. First, government costs are by nature not comparable with business costs since, for example, the government pays no taxes. Secondly, government bookkeeping procedures are different from business accounting practices, making comparisons difficult and misleading. Most important, justification of commercial activity on the part of the government on a cost basis "runs counter to the concept that the Government ordinarily has no right to compete in a private enterprise economy"[2] (emphasis added).

From this clear, simple statement of distinction between the proper role of the government (to govern) vis-a-vis the proper role of private enterprise (to conduct business), the Executive branch has modified by gradual stages over the ensuing years its policy of absolute reliance on the private, for-profit sector for goods and services required by the Federal government, ultimately reaching the point where, in 1979, the revision of the Office of Management and Budget (OMB) Circular A-76 --

the centerpiece of procurement policy -- included language that clearly gave precedence to cost-effectiveness over reliance on the private sector, and, further, negated any distinction between private, for-profit businesses and non-profit entities in terms of preference in awarding Federal contracts.

Despite these changes, the essential policy remains that the government should not compete with its citizens. Nevertheless, government does compete with the private sector, and on a vast scale. A recent study by the General Accounting Office (GAO) indicates that "an estimated 400,000 Federal employees are currently operating over 11,000 commercial or industrial activities at an estimated cost approaching $19 billion annually."[3] In other words, nearly one of every four employees of the Executive Branch civilian work force is currently engaged in activities which are clearly not of a policy, decisionmaking, or managerial nature, in direct competition with employees performing essentially the same activities in the private, for-profit sector. Yet a significant proportion of these activities cannot even be justified on a cost savings basis, in accordance with the dictates of Circular A-76. The GAO study points out that cost comparisons recently completed by the Department of Defense (DOD) "show that more than half of its commercial activities could be obtained more economically by contract."[4]

The amount of direct government competition with private enterprise is obviously extensive in terms of the cost, and is equally extensive in terms of the variety of goods and services involved. While the GAO study mentions a few of these activities, the best source work currently available on the subject is the report published in March, 1980, by the Task Group on Government Competition with Small Business, under the auspices of the Small Business Administration's Office of Chief Counsel for Advocacy. Comprised of eighteen small business owners, several of whom had experience with direct or indirect competition from government entities at the Federal, State or local level, the Task Force amassed a wealth of information from government officials, small business owners, and trade association representatives, and documented numerous specific instances of direct Federal Government competition with small firms. Examples include activities in areas such as audio-visual products and services, automatic data processing, printing and reproduction, basic business services, manufacturing, systems engineering, maintenance, real property, research and development, industrial shops and services, transportation and miscellaneous services. This list only partially covers the range of commercial/industrial activities performed by government employees -- all of which are readily available in the private, for-profit sector. Other activities come readily to mind, such as government owned-and-operated campgrounds, military post exchanges, and the relatively recent innovation of the House of Representatives liquor service.

The problem of direct government competition with business is extensive enough, but there is another aspect which is often overlooked but merits equally serious consideration, i.e., indirect competition. Indirect competition primarily exists in two forms: the awarding of Federal contracts and grants to non-profit entities; and Federal grants to states and local agencies, either through general revenue sharing or targeted funds, which are used to develop or sustain various in-house commercial and industrial activities on the state and local level.

The increasing role of non-profits in activities which have always been performed by private enterprise is a matter of deep concern to many businesses, in particular small businesses which cannot hope to compete on an equal basis against the subsidized resources and tax-favored status of the non-profits. Clearly there exists in the Federal procurement process an inherent bias towards non-profits. Some of the bias exists as a result of legislative action to promote certain social goals, as in the case of sheltered workshops, which are given preferential treatment in the awarding of small business set-asides by the Wagner-O'Day Act as a means of assisting the blind and severely handicapped. Yet the Advocacy Task Force received considerable evidence that the preference given sheltered workshops has not helped the handicapped community mainstream into the economic system, but rather has severely penalized the small business community and may have resulted in the exploitation of sheltered workshop employees.

Equally puzzling is the decided preference given to universities in the awarding of Federal contracts and grants. For example, universities have been favored in the awarding of billions of dollars for research. Yet all the evidence indicates that small business, while receiving less than 5% of all Federal R & D dollars, has contributed almost 1/2 of major U.S. innovations during 1953-1973.[5] In recent years the academic world has been the primary beneficiary of a wide array of Government-sponsored assistance programs, the bulk of the money for which often supports overhead expenses rather than being spent to assist clients as intended. Even more disturbing is the use of grant monies for such things as construction of motels to be owned and operated by universities, particularly when motels are already present in the area.[7]

The growth of state and local governments, largly fueled by Federal grants and revenue sharing, is another matter of concern to small firms, for this growth is accompanied by a concomittant increase in government competition on yet another level. During the period of 1953-1970, state and local Government employment grew from 8.6% to 14% of total non-farm payrolls. While much of the increase is attributed to education employment, non-educational state and local government employment also grew much faster than similar employment in the private sector -- a 79% rate for government as compared to a 33% private sector rate.[8] Clearly state and local government competition with small business is on the rise and is supported by the growth in aid and revenue-sharing programs of the Federal Government, programs which have had an average annual increase of 16% since 1965 and which amounted to $77.9 billion in 1978.[9] The chief difficulty with the grants program is its exemption from Federal policies such as A-76. For this reason, state and local government have little incentive to contract out for needed goods and services, for they are not even required to conduct cost comparisons to justify continuing in-house commercial and industrial activities. It is our belief that vigorous enforcement of A-76 within Federal agencies will solve only part of the problem of government competition with small firms. A second necessary step is to require state and local government recipients of Federal monies to conform to the same policies as their Federal counterparts.

One final and very positive point on the subject of state government competition with private enterprise needs to be made. This year the Arizona legislature passed House Bill 2184, titled "Government Competition with Private Enterprise". The bill creates a Private Enterprise Review Commission to review statutes and agency regulations and practices relating to state activities that compete with the private sector. In addition, the Commission is empowered to review the costs of state programs and determine if it is in the public interest to contract out these programs. Small business is to receive representation on the Commission. Further, the bill requires, with certain exceptions, that the state and all other political subdivisions charge sales tax on all goods that they sell. Arizona is to be commended for taking responsible action on the problem of government competition, and we hope that this bill is a harbinger of similar action by other states.

We have defined the problem, but what factors are essential to the solution? One obvious factor is the role that the Congress chooses to play in the debate over government competition. Historically, Congress has deferred to the Executive Branch in the determination of national policy on the subject of private sector reliance for goods and services needed by the Government. For example, Congress has never passed a resolution or law to mandate reliance on the private sector. Nevertheless, there has been precedent-setting activity in this area.

In the 83rd Congress two bills were under consideration, one of which would have established a permanent Anti-Government Competition Board. The other bill would have required the termination, except in the cases of national security, of all Federal commercial/industrial activities that competed with private enterprise. The bill also declared it Congressional policy that private competitive enterprise was to be encouraged and Federal activities in competition with business were to be minimized. While the bill was passed by the House and favorably reported out of the Senate Committee on Government Operations, the bill was never enacted, for Congress chose to defer to the Second Hoover Commission on the Organization of the Executive Branch, which was empowered to study and make recommendations on the subject of government competition with private enterprise.

In the ensuing years enactment of a Congressional policy of reliance on the private sector has been stymied by repeated attempts by the Executive Branch to "study the issue" and, in recent years, by a growing controversy within Congress itself over the proper course of action to take, largely fueled by the concerns of public employee unions and by the revelations of fraud and abuse within the procurement system. Such concerns led to the introduction in the last Congress of bills such as H.R.4717, introduced by then-Representative Herbert E. Harris, ostensibly to treat the very real problem of year-end ending sprees and wasteful Federal spending, but which would have had the practical effect of terminating contracting out and increasing in-house production of goods and services.

We do not question the validity of claims that fraud and abuse exist within the procurement process. We do, however, believe that it is patently absurd to condemn all businessmen for the unscrupulous practices of some, and at the same time to hold all public employees blameless. James T. Bennett and Manuel H. Johnson point out numerous instances of bureaucratic waste and inefficency in their excellent book, Better Government at Half the Price. Based on the evidence they uncover the conclusion seems inescapable:

> Clearly, the private sector could not waste money on useless contracts if the contracts were not given by bureaucrats in the first place. It is not the private firm that solicits contract proposals; it is the bureaucrat. It is not the private firm that reviews contract proposals; it is the bureaucrat. It is not the private firm that awards the contract; it is the bureaucrat. It is not the private firm that monitors the work performed once a contract is awarded; it is the bureaucrat. The message cannot be over emphasized: the source of contract waste is the public sector, not the private sector.[10]

Reliance on the private sector for goods and services needed by the government makes good sense, philosophically and economically. Government competition with private enterprise promotes serious concern about the proper function of government in a free enterprise economy. Over the past twenty years, GAO has issued numerous reports on the contracting process, and repeatedly has drawn a marked distinction between the proper role of the government employee (basic management function) and the private sector (commercial/industrial function). NFIB wholeheartedly agrees. In-house production of goods and services translates into lost income for small businesses. Lost income means lost tax revenues, from both the business itself and from the employees the business would have hired to perform the additional work that a Federal contract would bring. Further, reliance on the private sector would result in significant cost savings to the Federal government. Bennett and Johnson's book includes numerous instances of cost comparisons between the private and public sectors for a wide range of activities. The inescapable conclusion is that the private sector is significantly more efficient in delivering needed goods and services than is the public sector. As one economist stated, such findings lead to the suggestion of a "Bureaucratic Rule of Two: Removal of an activity from the private to the public sector will double its unit costs of production."[11]

A strong commitment to private sector reliance for the provision of needed goods and services is essential. Therefore NFIB wholeheartedly supports S. J. Res. 93, to clarify and reaffirm, by legislative mandate, this basic policy of reliance on the competitive private enterprise system. We applaud the Chairman for his introduction of this resolution and promise NFIB's assistance in achieving enactment for we believe, as GAO has stated:

> Without legislation, the executive branch can continue to unilaterally shift policy emphasis. Congressional action can preclude such unilateral shifts and establish a stable national policy. Such action would provide the necessary incentive for Federal agencies to implement the policy with assurance that it could not be changed again without Congressional approval.[12]

Mr. Chairman, thank you for providing me the opportunity to speak out on the vital issue of government competition.

Endnotes

1) Small Business Administration, *Government Competition: A Threat to Small Business* (Washington, DC: Office of the Chief Counsel for Advocacy, 1980), p.60.

2) Ibid., p.61.

3) U.S. General Accounting Office, *Civil Servants and Contract Employees: Who Should Do What for the Federal Government?* FPCD-81-43 (Washington, DC: Comptroller General of the United States, June 19, 1981), p.15.

4) Ibid.

5) Office of Management and Budget, *Small Firms and Federal Research and Development* (Washington, DC: Office of Federal Procurement Policy, March 10, 1971) as reported in Joint Hearings on Small Business and Innovation, August 9-10, 1978 (Washington, DC: Select Committee on Small Business and the Committee on Small Business) p.432

6) See, for example, the report by U.S. General Accounting Office, EED-79-113 (July 24, 1979) on expenditures in the Small Business Development Center program.

7) Small Business Administration, *Competition*, p. 145.

8) Ibid., p.98.

9) Ibid., p.110.

10) Bennett, James T. and Manuel H. Johnson, *Better Government at Half the Price* (Ottawa, IL: Caroline House Publishers, Inc., 1981), p.85.

11) Ibid., p.37.

12) U.S. General Accounting Office, *Civil Servants*, p.26.

Senator HAYAKAWA. If this legislation of Congressman Dreier and I is passed, whose responsibility would it be within Government to see that it is implemented down the line—the OMB?

Mr. MCKEVITT. OMB, I would think, would be the one. No. 1, I would like to see the Advocate, the Chief Counsel for Advocacy, SBA, involved. I think that OMB would have the primary overview.

Senator HAYAKAWA. Tell me about Advocacy.

Mr. MCKEVITT. It was created, you know, during your term several years ago. Mr Frank Swain, former NFIB legislative counsel, occupies that position.

Senator HAYAKAWA. The SBA Office of Advocacy?

Mr. MCKEVITT. Right.

Senator HAYAKAWA. I see.

Mr. MCKEVITT. It was done under Milt Stewart. As a matter of fact, we made reference to one of his studies in here on Competition, and I think they would be a good watchdog to look over that as well.

Senator HAYAKAWA. Let me put all of this in terms of my own private experience. Government-operated PX's are a perfect example, are they not, of Government interference or taking over in the private sector? They originally were set up overseas to provide American goods for American servicemen overseas. There is no particular need in, say, Novato, Calif., where there is a huge PX?

Mr. MCKEVITT. The problem you get into is the service of troops on the base, and another is to have liberal tendencies like the credit card situation that developed. We worked with two Members of Congress, one, Charlie Rose in North Carolina, to stop it. You would have thought we were a bunch of Communist in the bush, the kind of letters we got and the coverage by Army Times, among others. We put a stop to the liberal policy.

But you get all kinds of people off base, nonmilitary people buying things on the base, "Get me so and so while you are there." That has a tremendous impact on the retailers and wholesalers off base.

Senator HAYAKAWA. When a PX sells things at less than the usual market price, retail price, which is their prinicipal attraction, are they running at a loss?

Mr. PROUTY. Not normally. They will use their bulk purchasing power through a central buying capacity and buy in much greater quantities than a small businessman can do, even though you are a distributor or wholesalership. Their cost of delivery of that particular good will not normally be at a loss.

Senator HAYAKAWA. If you account for everything else that normal businesses have to account for, like occupancy of space, taxes, and so on, would the same conclusion hold?

Mr. PROUTY. Probably not. They are exempt from normal sales tax.

Senator HAYAKAWA. Exempt from normal sales tax as well as other business expenses?

Mr. PROUTY. Yes.

Senator HAYAKAWA. I want to ask, apparently a silly question, is the Senate dining room run by the Government or is it franchised out?

Mr. PROUTY. All Government employees.

Mr. MCKEVITT. The Government is competing with the local liquor stores in the area so far as selling of alcohol is concerned, too. If you want to have a reception up there, you buy alcohol from the House restaurant rather than going over to the private stores in the area.

That is one of the things that we feel very keenly about. None of the factors that make the private sector successful seem to be used for Government, such as you ask, "Do they make a profit?" It doesn't seem to make much difference whether they do or not. And as Congresswoman Patricia Schroeder said, "If you put these particular factors in operation in the Government, you would be killed." She said, "If you are lean and mean and effective, you get killed in Government service, because the main thing is to expand the staff and get more appropriations." That is the reason we feel very keenly that they are operating at a loss. If they are not operating at a loss, they are keeping the conclusion very secret indeed.

As Mr. Prouty has indicated they order in large lots, which is your point, along with the factor of built-in nonprofit tax exemption, that is a big hue and cry we hear from our members in that area, "How can I compete with a purchaser who is buying in large lots and selling under my costs?" And it is not small potatoes by the way, we are talking about big items, big ticket items, stereos, $600, $700, $800, $1,200, $1,500; motorcycles, and so forth, just like going back to the old days of selling cars again, the exchange used to sell all of that.

Senator HAYAKAWA. The problems presented to us here this morning seem to be so huge, so gargantuan in scope, I am really bewildered as to where to start attacking it.

Mr. MCKEVITT. Maybe you ought to take a page out of Arizona's book with what they have done.

Senator HAYAKAWA. What have they done?

Mr. MCKEVITT. I make reference in there to the law in Arizona, for example, on how they are tightening up. I think they were interested on featuring what they have done, like with the fire department, like what they have done with management, farming out accounting as far as municipal government is concerned. It is a matter of using one's imagination and determining what they can offer, not setting up pork-barrel projects like setting up Small Business Development Centers, paying universities to teach small businesses how to run their business. Our members are up in arms about that. At the White House Conference on Small Business the delegates practically ran them from the House, they voted out the task forces, here is the old giveaway program, they are going to pay the overhead of business schools. I don't want to get off on that, one of my favorite topics, but it is one example. But the thing takes the positive examples, which is surprising to some people, things may be a gimmick on Mike Wallace's show on Sunday night out in Arizona, but they have effective programs, as I say, fire department, or where there is an accounting method, where they are contracting their services out and being very effective at it. Police services is another one we see more and more.

Senator HAYAKAWA. They can contract out police services, fire department services?

Mr. MCKEVITT. Right.

Senator HAYAKAWA. Food services?

Mr. PROUTY. The Medevac services, which was my issue.

Senator HAYAKAWA. Paramedics, ambulance services are things that can all be farmed out. Garbage collection is farmed out in some communities at a considerable saving in costs. For example, just compare the cost of the garbage site system in San Francisco with the one in New York. Where it is publicly funded, as in New York, the prices are astronomical, you have the built-in pensions, retirement benefits, and all sorts of things for the garbageman in the one place, in the other place they give it to them out of the contract.

Mr. PROUTY. You asked the question of where do you begin to attack so monumental a task as this.

Senator HAYAKAWA. Yes.

Mr. PROUTY. I think probably the key issue at all levels is education. I do a lot of work in schools in cooperation with the community and colleges throughout California. It is a very, very sad state of affairs when you walk in and address a group of secondary schoolteachers and ask them what the net profits as a percentage of gross sales of a small business in this country is and get consistently 40 to 60 percent. You ask the students the same question in junior high and senior high, and you get to 50 to 60 percent. Yet you ask them how many of them at that level are going into business for themselves when they graduate from school, out of a class of 30 you may get 1 or 2.

We have to reorient the educational process in this country to let them know that when you are dealing with Government, that the profit margin of a company is not tacked on, it is part of the price, and that really profit is not a four-letter word, but loss is, and that comes from education of our congressional and elective officials, it comes from the development of good entrepreneural education within the elementary and secondary schools and univerities, and becomes critical to educated small business of the part it plays in our economy. The chamber does an effective job in helping the small business person whose basic job today in this economy is putting out fires, trying to just stay alive long enough until hopefully something will turn around, and unfortunately many of them aren't, and the increase in bankruptcies in this region alone is up dramatically and will continue to accelerate until something can be done within this area.

Senator HAYAKAWA. I don't want to keep you too long past our adjournment time, but I would like to ask one other question. Ordinarily in the school system, school cafeterias and so on, those are not private enterprises, not farmed out. The schools hire personnel and the staff makes the decision about what food shall be served to the students and so on. To what degree are there school systems that simply go out to the principal fast food suppliers and restaurants in town and say, "How would you like to take over our cafeteria?"

Mr. PROUTY. Some of them are trying.

Senator HAYAKAWA. They are?

Mr. PROUTY. There was an article in the Wall Street Journal that even McDonald's was getting involved.

Senator HAYAKAWA. Were they a success?

Mr. PROUTY. The kids love it. The question is nutritional levels of some of the foods, you know, are seriously in question. But with the regulations that have existed, in some instances while food hasn't been palatable for the kids, it has a higher nutritional value than the typical fast-food meal.

Senator HAYAKAWA. Can the effectiveness of the fast-food chain and the nutritional value recommended by the home economics department be combined?

Mr. MCKEVITT. I think it can, by setting out specs on what you want in the way of nutritional content, and I think they can respond to it.

Mr. PROUTY. It is a rather large marketplace. You look at most of the high schools, and McDonald's and Carl's Jr. and everybody else has put units on the periphery around the schools, which means that the food delivery system within the high schools, most of these are operating at a loss, having food left over, because the kids are leaving, they are going outside.

Senator HAYAKAWA. They are even leaving behind the school lunches provided by the taxpayers in order to go across the street to get a "Big Mac."

Mr. PROUTY. Right.

Senator HAYAKAWA. My goodness. I am simply overwhelmed.

Mr. George Adams would like to speak from the audience on Government competition with the private sector. You are Mr. George Adams, are you?

Mr. ADAMS. Yes.

Senator HAYAKAWA. I should be happy to include your oral statement in the record of the proceedings, this morning.

Mr. ADAMS. Thank you very much.

Senator HAYAKAWA. Is that satisfactory to you?

Mr. ADAMS. Yes, it is.

Senator HAYAKAWA. It will go right into the record.

Mr. ADAMS. I would like to make a couple of comments, if you would permit me.

Senator HAYAKAWA. Please come forward.

Goodbye, gentlemen.

Since we are past the adjournment time, Mr. Adams, please make it short, but you are most welcome here.

STATEMENT OF GEORGE ADAMS

Mr. ADAMS. In trying to give an example of Government intervention in small business and business in general, I would like to point out the extent that the Department of Transportation is doing in building up the El Pueblo facilities as well as the Ohio transportation testing facilities, and that is where a great amount of funds are directed to nonprofit institutions like universities, detrimental to the small business and business dedicated to that industry. Morwell Systems Co., over which I preside, recently have been affected by funds who have been contracted to projects have been contracted to the University of Michigan and other universities, contracts that should be going to small business or to ourselves, which we are also small business.

Senator HAYAKAWA. Thank you very much. Another whole area I have not been aware of is that of the Federal Government taking over the vehicle testing business in the El Pueblo facilities in Cleveland. Thank you very much. I will put it into the record.

Thank you for attending. The hearing is adjourned.

[Whereupon the hearing adjourned.]

GOVERNMENT COMPETITION WITH SMALL BUSINESS

WEDNESDAY, NOVEMBER 4, 1981

U.S. SENATE, SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS,

Washington, D.C.

The subcommittee met, pursuant to notice, at 10:30 a.m., in room 424, Russell Senate Office Building, Hon. S. I. Hayakawa, chairman of the subcommittee, presiding.

Present: Senators Hayakawa and Dixon.

Also present: Kimberly A. Elliott, professional staff member; Alan L. Chvotkin, chief counsel, minority; Margaret M. Broadbin, hearing clerk; Grace Hussie, Senator Hayakawa's staff.

Senator HAYAKAWA. The hearing will please come to order.

STATEMENT OF HON. S. I. HAYAKAWA, A U.S. SENATOR FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS OF THE COMMITTEE ON SMALL BUSINESS

Senator HAYAKAWA. This, ladies and gentlemen, is the third hearing scheduled this year by the Small Business Subcommittee on Advocacy and the Future of Small Business to consider the problem of Government competition with small business.

We have learned a great deal about this issue up to now, although I believe there is still much to learn on this vast and complicated topic. We have heard from the Office of Management and Budget, the General Accounting Office, small business owners, and representatives of trade associations, all of whom support the joint resolution which I introduced along with Congressman David Dreier of California back in June.

Again, the purpose of the resolution, Senate Joint Resolution 93, is to reaffirm the longstanding Federal policy of reliance on competitive private enterprises to supply the goods and services needed by the U.S. Government.

However, I wish to observe that none of us are insensitive of the concerns of some Federal employees about the possible loss of Government jobs as a result of increased Federal reliance on the private sector to perform commercial and industrial activities.

Because I believe that such views are necessary to insure a balanced hearing record, I invited the American Federation of Government Employees to testify at this hearing. However, that union did not accept the invitation to be here with us today. I truly regret this fact since I would have liked to learn firsthand of its opinions on Senate Joint Resolution 93.

Today we will hear from the Chief Counsel for Advocacy of the Small Business Administration who will provide us with a broad overview of the Government competition issue.

The subcommittee will also consider two recent General Accounting Office documents: First, a letter to the Secretary of Defense that questions the exemption of about 80 percent of DOD's commercial activities from the efficiency review program which is required before a commercial activity can be converted from inhouse to contract operations. Second, the subcommittee will receive testimony on a recent GAO report entitled "GSA's Cleaning Costs Are Needlessly Higher Than in the Private Sector."[1]

Finally, we shall hear from a panel of small business owners who provide services to the Government and who have interesting stories to tell about how Government competition has affected their industries. I wish to take this opportunity to express my appreciation to all of the small business people who have been good enough to take time to contribute so much to our hearing record.

While the subject of increased contracting out or reliance on the private sector is not a simple one to solve, I believe it should be examined and appropriate action should be taken by Congress to channel as many commercial and industrial activities to the private sector as possible. This will not only help reduce the overall cost of Government, which is indirectly borne by American taxpayers, but it will also transfer jobs to the private sector that in turn will stimulate local economies.

I am pleased that so many organizations have expressed their support for our efforts. I also am delighted that the Director of the Office of Management and Budget, Mr. David Stockman, who is responsible for the Government's procurement programs and who, as everyone knows, is dedicated to reducing the cost of Government, supports Senate Joint Resolution 93. In fact, Mr. Stockman recently wrote to express his sentiment on this issue.

Before we get started this morning, I would like to read his letter to you and request that it be included in the hearing record. Rather than read the whole thing, I will read only the key paragraph from Mr. Stockman's letter:

> Accordingly, the Reagan administration would welcome a clear statement of intent by Congress to support the policy that the Government should not compete with its citizens, and should rely upon the competitive private enterprise system for needed goods and services. We, therefore, enthusiastically and fully support the Senate Joint Resolution 93, which you introduced on June 22, 1981. It is an excellent means to clarify and reaffirm this as a national policy and will illustrate to the public and private sectors alike that it is truly the Government's policy to rely on the private sector for needed commercial and industrial goods and services. The resolution provides timely support for President Reagan's quest for a new, revitalized approach to strengthening this country's economy. Economy and efficiency in Government and reward of the private sector for initiative and productivity are necessary ingredients in our formula for economic renewal.

[Material follows:]

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[1] The report entitled, "GSA's Cleaning Costs Are Needlessly Higher Than in the Private Sector," dated Aug. 24, 1981, has been retained in committee files.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Honorable S. I. Hayakawa
United States Senate
Washington, D. C. 20510

Dear Sam:

On October 28, 1981, I testified before the Joint Economic Committee on the Impact of Government Competition on Small Business. My testimony centered on implementation of OMB Circular No. A-76, which sets forth the Government's policy of reliance on competitive private enterprise for commercial or industrial products and services required by the Government.

We estimate that the Government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion with a similar amount of capital investment. The vast majority of these activities has never been subject to competition. If these activities were subject to the cost comparison studies required by A-76, we estimate that as many as 154,000 personnel spaces could be converted to private sector contract operations with a 5-year cumulative savings between fiscal years 1982 and 1987 in excess of $3 billion. These savings will continue to accrue thereafter.

The potential for such savings has been recognized for a long time. Since 1955, each Administration has expressed a general policy of reliance on the private sector for services needed to support the accomplishment of agency missions. The most recent expression of this policy was published in 1979. However, the policy has been applied unevenly over these Administrations, and it is now time to make it work.

Accordingly, the Reagan Administration would welcome a clear statement of intent by the Congress to support the policy that the Government should not compete with its citizens, and should rely on the competitive private enterprise system for needed goods and services. We, therefore, enthusiastically and fully support the Senate Joint Resolution 93, which you introduced on June 22, 1981. It is an excellent means to clarify and reaffirm this as a national policy and will illustrate to the public and private sectors alike that it is truly the Government's policy to rely on the private sector for needed commercial and industrial goods and services. The Resolution, provides timely support for President Reagan's quest for a new, revitalized approach to strengthening this country's economy. Economy and efficiency in Government and reward of the private sector for initiative and productivity are necessary ingredients in our formula for economic renewal.

Sincerely,

David A. Stockman

David A. Stockman
Director

Senator HAYAKAWA. Senator Dixon, do you have an opening statement?

Senator DIXON. No, I do not, Mr. Chairman. I simply congratulate you on the outstanding work you have done as chairman of this subcommittee. I am delighted to be here for this hearing.

Senator HAYAKAWA. Thank you, Senator.

We shall proceed then with the first witness, Mr. Frank S. Swain, Chief Counsel for Advocacy, Small Business Administration, Washington, D.C.

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.

Mr. SWAIN. Thank you very much, Mr. Chairman.

It is certainly a pleasure to appear before this committee, particularly this subcommittee. This is my first opportunity to appear before your subcommittee, which of course is the oversight subcommittee over my office, of the Office of Advocacy. I am very happy to appear on an issue which is likewise so important and essential to small business.

The Office of Advocacy has had a strong and continuing interest in the whole issue of contracting out and Government competition with small business. We have a statement which I would like to submit for the record and just briefly summarize if you will allow me to.

Senator HAYAKAWA. Thank you. Please do so.

Mr. SWAIN. In March 1980, the Office of Advocacy issued a report of a task force which it formed of affected and interested business people to assess the problems with Government competition with small business and to make some recommendations.

The task force report is now a year and a half old. I think it is a recent documentation of the problems that small business has been having with the issue of contracting out Government competition with small business. We feel that the recommendations of the task force as to the problems of the small business community could, while not solved, be appropriately ameliorated by a strong statement of congressional interest in this issue such as Senate Joint Resolution 93.

I think it is appropriate for the legislative branch to declare and affirm as a national policy a view that it is not the function of the Federal Government to compete with small business, but rather the Federal Government must rely on competitive private enterprise to supply its needed goods and services.

I know that in your previous hearings on this issue you have certainly had the figures cited on the costs of competition with small business and of possible savings to the taxpayer. However, this is really the driving force behind this issue and I think it is appropriate to repeat them.

The Office of Management and Budget estimates that Federal employees perform 11,000 commercial or industrial activities, many of which could have been performed by responsive and responsible small business firms. The cost of these activities was approximated to be $19 billion.

The Advocacy task group on Government competition very conservatively estimated that the potential savings to the taxpayer was in the neighborhood of $3 billion in average annual savings if 85 percent of these commercial and industrial activities now performed by the Government could be performed by the private sector.

I think the statistics compiled by SBA on the rate of small business participation in Federal procurement highlight the particular degree of urgency that this problem poses for small business right now. Despite the best efforts of the Congress and despite good efforts by many administrative agencies, the sad fact is that the net proportion of small business participation in Federal procurement has not been increasing. In fact, it has declined slightly over the last few years. We attach some figures in our statement to document that.

The whole problem is that procurement is a very technical and complicated issue. Many times there are good reasons why procurement does not go to small business.

We see the contracting out issue, the issue of whether the Government ought to be performing many functions or whether the private sector ought to be performing them, as the key of enlarging this procurement pie. The best way to open up procurement for small business, we feel, would be for the Federal agencies to aggressively pursue a policy of contracting out to the private sector whenever that is appropriate.

SBA has met with success in making numerous small business concerns aware of business opportunities available in Federal contracting. However, because of the declining small business share of total Federal procurement, many contracts currently being performed by small businesses are essentially simply being passed around within the small business community, and there has been no real net growth.

I think one way to insure enough contracting opportunities for all small businesses would be to fully implement a Federal policy of reliance on the competitive private sector for the Government's needed goods and services.

I think certainly that with the imminent buildup in the defense budget and the procurement opportunities there will be a great opportunity for the private sector in general and small business in particular to add to this Nation's defense base. This committee has held hearings on that issue in the past few months.

I think small businesses are capable of doing much of the logistics work currently done in-house and would benefit greatly if research and development currently performed by Government laboratories was contracted out more.

Let me give you an example of one instance in which the Office of Advocacy was able to take part. I am sure it is just the tip of the iceberg.

In early 1980, the Coast Guard had begun manufacturing surf rescue boats at a Coast Guard yard in Maryland. A small business contacted us, the Willard Co. of Fountain Valley, Calif. They questioned whether the Coast Guard ought to be making these boats or whether it was more appropriate a job for the private sector.

Apparently the Coast Guard had not paid an awful lot of attention to Circular A-76.

The Office of Federal Procurement Policy agreed with the Office of Advocacy's position that this was in-house boat building and it was a new start as defined by the circular. Therefore, the OFPP requested that the contracting activity comply with the OMB circular and that it be contracted out.

Eventually, after working through the administrative structure for a while, the decision finally was made that this was a new start and it was an activity that should be contracted out.

This is just one example, and probably a pretty small one given the total range of the Federal budget and the defense budget, but I think it is indicative of the fact that without a clear and careful statement of intent from the Congress, the natural inclination of the Federal departments will be to continue in-house activities.

The Federal Government has been looking at mechanisms for reforming this for some time now. Since 1955 there has been a series of OMB orders and circulars, the most recent circular involving the contracting out issue being OMB A-76 which was revised in April 1979.

Unfortunately, we believe that the 1979 revision of OMB A-76 represents a departure from past forms, primarily because it does away with the decided preference for the private sector. It introduces a strong technical element of cost comparison, which I think in the abstract can be absolutely justified. However, unfortunately, as this cost comparison process is applied, it runs into some real problems.

For one thing, it is particularly complicated. There is no uniformity throughout the Government for cost comparison. For another thing, the cost comparison data ignores the fact that the Government production of private goods and services seldom takes advantage of what ought to be natural efficiencies of skill within the Government. Finally, I think it ignores the fact that the Government agencies have no natural incentive to contract out at the lowest possible cost. They just do not operate on a bottom line formula.

Therefore, although OMB A-76 is certainly a step in the right direction, we feel it would be appropriate for the Senate and the Congress to clarify its intent that there be a decided preference for contracting out to the private sector for goods and services whenever that is available and whenever it is most efficient for the Government to do that.

We really need some clear direction. The executive agencies and the independent agencies need clear direction from the Congress. I think the small business community would applaud that direction. They certainly applaud your efforts and the committee's efforts in looking into this problem so carefully.

Thank you.

Senator HAYAKAWA. Thank you, Mr. Swain.

I have a couple of questions to raise. First of all, I would like to compliment you on using that wonderful example of the Willard Co. of Fountain Valley, Calif. and the manufacturing of surf rescue boats by the Coast Guard in Maryland. I understand that this individual company felt it ought to be performing the work instead of having the Coast Guard do it in-house.

As you said, it is only one of many, many possible example, but I am fascinated that you brought this particular one up because it illustrates how much redtape you have to go through to do even the sensible thing. You say that the Office of Federal Procurement Policy agreed with the Office of Advocacy's position that in-house boat building constituted a new start, et cetera. You had to go back and forth with memorandums, questions, clearances, and so forth before the small firm could get started on the work. That process should be simplified, should it not?

Mr. SWAIN. Absolutely. This whole area is, I think, one of the mushiest right now to try to get a handle on if you are working on a particular problem with a particular contract.

Senator HAYAKAWA. Is it your impression that because of these complexities some small businesses simply avoid the Federal market?

Mr. SWAIN. I do not think there is any question about that, Senator. The contracting process is a very complicated process. You can be half way through it and someone can change his mind or decide that the contract ought to be performed in-house. The small business just does not know where the clear signals are. It is a terribly complicated process.

Senator HAYAKAWA. Can that process be simplified?

Mr. SWAIN. I think that it can be simplified. As you are probably aware, Senator, the Office of Management and Budget is about to release, if they have not just released, a proposed simplification of uniform procurement rules for the Federal Government. My office certainly does not agree with everything in that proposal, but at least it is a serious step in the right direction.

Senator HAYAKAWA. That would help a lot.

Do you have any recommendation for improving the cost comparison guidelines outlined in A-76?

Mr. SWAIN. We do have some specific recommendations Senator. We would be happy to provide those for the record.

[Subsequent information was received and follows:]

SBA U.S. Small Business Administration Washington, DC 20416

NOV [illegible] 1981

Honorable S. I. Hayakawa
Chairman
Subcommittee on Advocacy and the
Future of Small Business
Senate Select Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As I promised in my November 4, 1981, testimony on Government Competition and Small Business which was made before your Subcommittee on Advocacy and the Future of Small Business, I offer the following recommendations for improving the revised OMB Circular A-76:

1. In the section on Policy, the preference for the private, competitive free enterprise sector should be reinstated.

2. The Circular's definition of "private commercial source" should distinguish private, for-profit businesses from "non-profits" and assert a preference for the former.

3. The statement of Purpose in Revised A-76 should be broadened to make clear that the Circular is intended to cover procurement of goods as well as services.

4. All agency determinations that continued in-house government operation of a commercial or industrial activity is authorized because no satisfactory commercial source is available or justified on the basis of national defense should be subject to review by the Office of Management and Budget.

Thank you for the opportunity to testify on this significant small business issue. If this office can be of further assistance to you on government competition or other small business issues, please do not hesitate to contact me on 653-6533.

Sincerely,

Frank S. Swain

Frank S. Swain
Chief Counsel for Advocacy

Mr. SWAIN. The key thing is that the cost comparison guidelines issue is an issue that accountants could argue about until the 100th or 110th Congress is in here. I think the cost comparison guidelines simply have to be one factor in the contracting out process. That should not be the absolute control. We should not wait until we get the *n*th degree of detail on cost comparison before we make the decision to contract out or not. I think in many cases it is simply an excuse for delay.

Senator HAYAKAWA. In your statement, you recommend that Federal agencies report on their implementation of Senate Joint Resolution 93.

Mr. SWAIN. Yes, indeed.

Senator HAYAKAWA. Do you have any suggestions as to what Government office should coordinate these reports for transmittal to Congress?

Mr. SWAIN. I think that the reporting function is an important function because there is no consistency between and among the Federal agencies and between and among executive agencies as opposed to independent agencies on how well they are following the circular. I do not have an absolute suggestion on who ought to do the coordination. It possibly could be done by the Office of Management and Budget. It possibly could be done by the General Accounting Office. It possibly could be done by SBA, either my office or the procurement office within SBA.

I think the coordinating body is not the important fact. The important fact is that this committee and the Congress ought to be asking questions of each individual agency of how well they are doing.

Senator HAYAKAWA. Your office should be bringing this issue to the attention of the small business community, should it not?

Mr. SWAIN. Absolutely.

Senator HAYAKAWA. By what means are you doing so?

Mr. SWAIN. Of course the task force report was the major work that the small business community has done in this area, but without a law to really hang a particular complaint on, we just have to approach the issue on a case-by-case basis. Of course, we follow up on any cases we are aware of. We have it as a frequent subject of discussion at the small business forums that are held around the country to try to make contractors and small business people aware that they ought to be asking serious questions about this issue.

However, until the Congress acts either by resolution or by law, as I say, it is a very slippery slope and there is no real central point to approach.

Senator HAYAKAWA. Senator Dixon, do you have any questions?

Senator DIXON. Thank you, Mr. Chairman.

Mr. Swain, I think you and my friend, the chairman, were discussing when I was outside of the room a moment ago the problems that some small businessmen have with the Federal procurement process. I missed that exchange.

However, I would like to call to your attention the fact that the Illinois congressional delegation recently sponsored Federal procurement sessions in Chicago and in Springfield, Ill. Over 1,000 people came to Chicago, and over 250 came to the Springfield meeting.

One of the complaints we heard from the small businessmen and women was that, in their view, the procurement process was extremely complicated. I presume that is the exchange that you and the Chair were having in my absence?

Is there a continuing effort being made to address that problem by various Federal agencies?

Mr. SWAIN. Absolutely. Under congressional directive, the Office of Management and Budget has to submit to the Congress a proposal for simplifying all the procurement rules that the Federal Government uses. I think that proposal has just been released within the last week.

As I mentioned to the chairman, my office is not particularly enthusiastic about every single thing in that proposal, but at least it is a start in the right direction, and it allows the Congress to bring this to the attention of the small business community and the contracting community and try to get some simplification.

Senator DIXON. I wonder if you would be kind enough to send me a copy of that proposal. I have not seen that. I would greatly appreciate it.

Mr. SWAIN. Yes, indeed.

Senator DIXON. There is one other thing I wanted to bring up with you. Although I appreciate that it may not be particularly your area of responsibility, it is something that I would like to call to your attention. There is something around here called the sole-source process. Certain contracts are awarded without bids. Are you aware of that process?

Mr. SWAIN. As you indicated, Senator, I am not a technical expert on every procurement program, but, yes, there are a variety of sole-source methods whereby certain contracts are awarded without competition. Agencies have various contracts that they award in that manner. I think that the general attitude of the administration and the agencies has been to try to get away from that technique whenever possible.

Senator DIXON. I would like to call to your attention a situation that recently that was brought to the attention of the Illinois congressional delegation. International Harvester in our State wanted to bid on, I think, the M-9. A sole-source award had been made to an Oregon firm. We complained to the Secretary of the Army and others about that sole-source award.

I think that is a bad process. I cannot see how that process is in the interests of the taxpayers of this country. To the extent that you and others can address that problem from the standpoint of procurement, I would appreciate your doing so.

Mr. SWAIN. We certainly will get some more information on that and get back to you, Senator.

Might I add that one of the problems I think is characteristic of both the sole-source issue and the small business issue is, if a contracting officer in a Government agency is used to dealing with a particular company, then it is a lot easier for him to go back to that company on a continuing basis.

It is also a lot easier for him to make one $20 million award to a large company than 20 $1 million awards to 20 different small companies. It is just a way of life in the bureaucracy too many times. It is a terrible challenge for both the small business community and for those of us within the Government who would like to free up this procedure a little bit.

Senator **Dixon**. I hear that, but the curious part about this is that International Harvester first manufactured the M-9. I think the Secretary's position is indefensible.

Thank you, Mr. Chairman.

Senator **Hayakawa**. Thank you, Senator.

Thank you, Mr. Swain, for your testimony.

Mr. **Swain**. Thank you, Mr. Chairman. I have enjoyed it.

[The prepared statement of Mr. Swain follows:]

SBA U.S. Small Business Administration Washington, DC 20416

STATEMENT OF
FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY
U.S. SMALL BUSINESS ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON ADVOCACY
AND THE FUTURE OF SMALL BUSINESS
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
November 4, 1981

MR. CHAIRMAN AND MEMBERS OF THIS SUBCOMMITTEE:

I. INTRODUCTION AND BACKGROUND

Thank you for providing me the opportunity to testify today. As Chief Counsel for Advocacy for Small Business, I represent the interests of small businesses where regulations, policies and actions of Federal agencies affect small business. The problem of government competition with small business is of great concern to this office since it poses a threat to the continued viability of many small businesses and effectively closes out opportunities otherwise available to many other small businesses which wish to do business with the Federal goverment.

Since the issuance of the March, 1980 Report of the Small Business Administration (SBA) Advocacy Task Group on Government Competition with Small Business, the problem has often been discussed but little in the way of new positive action to alleviate the situation has been seen. Therefore, it is heartening to see that with S.J. Res. 93, the legislative branch will finally clarify, declare, and affirm as a national policy a view which I hold - that it is not a function of the Federal government to compete with small business, but rather, the Federal government must rely on competitive private enterprise to supply its needed goods and services.

In an often-cited study, the Office of Management and Budget (OMB) has estimated that Federal employees perform 11,000 commercial or industrial activities, many of which could have been performed by responsive and responsible small business firms. The cost of these activities was approximated to be 19 billion dollars. The Advocacy Task Group on Government Competition had very conservatively estimated potential savings to the taxpayer of 2.98 billion dollars in average annual savings if 85% of those in-house activities that are presently justified in non-cost terms was opened up to competition.

The statistics compiled by the SBA on rate of small business participation in Federal procurement have not been encouraging. Despite the efforts of SBA and the various

Offices of Small and Disadvantaged Business Utilization (OSADBU) in contracting agencies, the average annual increase in percent of total Federal procurement awarded to small business between 1970 and 1978 was less than 1%. Since 1979, despite the passage of P.L. 95-507, the small business share of total Federal procurement has actually been declining. The attached table makes this dismal statistic all too clear. Preliminary figures for 1981 indicate that this downward trend is still continuing.

SBA has, however, met with success in making numerous small business concerns become aware of business opportunities available in Federal contracting. Unfortunately, because of the declining small business share of total Federal procurement, many contracts currently being performed by small businesses are essentially being passed around within the small business contracting community. One way to ensure enough contract opportunities for all small businesses would be to fully implement a Federal policy of reliance on the competitive private sector for the government's needed goods and services.

It is critical even in times of peace to maintain the defense industrial capability of this country. Reliance on the private, especially small business, sector, would greatly aid in this effort since small businesses constitute a significant part of the defense industrial base of this country. This point has already been highlighted in the July 14, 1981 Senate Small Business Committee hearings on the problem of the eroding defense industrial base. Small businesses are capable of doing much of the logistics work currently done in-house and would benefit greatly if research and development currently performed by government laboratories were contracted out. Government contracts to small business would not only produce needed weapons but would assist small businesses in innovation and development of new weapons systems.

One example of how this office has attempted to assist a small business with a government competition problem in the defense sector is the case of the Willard Company of Fountain Valley, California. In early 1980, the Coast Guard had begun manufacturing surf rescue boats at the Coast Guard Yard, in Curtis Bay, Maryland. Advocacy questioned whether or not this activity complied with OMB Circular A-76. The Office of Federal Procurement Policy (OFPP) agreed with Advocacy's position that this in-house boat building constituted a new start as defined by the Circular, and not, as the Coast Guard argued, a manufacturing capability that had been in place for several years which should be treated under the conversion rules in the Circular. The OFPP accordingly requested the contracting activity to comply with OMB Circular A-76, and to treat the manufacture of the surf boats as a new start.

The contracting activity disagreed with the OMB's position. However, they stated that because the workload at the Yard was significantly increased by the assignment of several ship renovation programs and because of attrition of the labor force due to a hiring freeze, they agreed to contract the manufacture of the surf boats on a competitive basis.

II. PAST FEDERAL POLICY ON GOVERNMENT COMPETITION AND REVISED OMB CIRCULAR A-76

There can be no meaningful discussion of the problem of government competition without some reference to the history of Federal policy on this matter. Until the introduction of S.J. Res. 93, Federal policy has expressed preference for the private sector, through a series of Bulletins and Circulars issued by the Executive Branch beginning in 1955. The latest Circular is OMB Circular A-76 which was recently revised in 1979. This 1979 revision of OMB Circular A-76 represented a departure from past forms primarily because it does away with the decided preference for the private sector. As Study Group One of the Commission on Government Procurement commented on revised Circular A-76 - "the policy of government reliance on private enterprise has been subjugated to cost comparison on a basis that tends to favor in-house performance."

The cost comparison approach in A-76 was adopted in order to achieve desired uniformity throughout the government and to provide "more precise guidance in developing cost estimates and analyzing comparative costs." Although it may achieve uniformity in results, the cost comparison feature is complex and expensive to perform because it must be done by personnel with an accounting background. It is decidedly skewed in favor of in-house activity, as indicated by factors such as the comparison is conducted by in-house agency personnel and specific authorization for in-house performance is made when use of a private sector concern would cause a very vaguely worded "unacceptable delay or disruption of an essential agency function."

There are other factors associated with the complexity of the government competition problem which the A-76 cost comparison approach does not adequately address. To delineate this point, I would like to summarize the testimony of two economists who appeared at the 1979 Advocacy Task Group Hearing on Government Competition and identified the flaws in the economic basis for the revised A-76 policy. First, they maintained that government production of private goods and services seldom takes advantage of efficiencies associated with economies of scale. Accordingly, the costs of government production of goods and services are generally higher because fixed costs are averaged over smaller output than for private firms, which do not have to confine their output to the needs of a particular bureau or segment of a governmental agency. Second, they maintained that governmental agencies typically have no incentives to lower the cost of production. In a free market economy, resources are efficiently allocated by the market system, and the price of goods and services will dictate the optimal levels of output. Businessmen seek to minimize their costs in order to sell at a competitive price since failure to do so usually results in business failure.

Accordingly, workers in the private sector are given bonuses as incentives to meet the general sales and cost goals set by management. Successful and ambitious workers who meet these goals will be appropriately compensated whereas their counterparts in the government will not.

Notwithstanding the merits of the cost comparison analysis in A-76, from this office's experience with A-76, it is doubtful that the affected agencies are implementing it to the full extent OMB had intended.

III. NECESSITY FOR S.J. Res. 93

In light of all of the foregoing, S.J. Res. 93 is a statement of congressional policy which has been long awaited and is long overdue. This establishment of clear direction from Congress, implementing longstanding Executive Branch policy, may be the impetus the agencies need to contract out more of the activities which should be performed by the competitive private sector, especially the small business sector.

I strongly support this Resolution as a boon to greater small business participation in Federal procurement because among other things this Resolution would:

- Provide an incentive for OMB to review its cost comparison analysis method to tilt more favorably towards small business and the private sector.
- Give businesses a preference over not-for-profit institutions, which compete for many of the same Federal contracts with small businesses.
- Include all Federal agencies within its coverage, unlike OMB Circular A-76 which applies only to executive agencies.

This Resolution would also still allow flexibility to the Executive Branch to formulate and carry out procurement policies, consistent with the Resolution. Finally, if you will permit me to make a suggestion, in order for Congress to show its concern that this national policy is really being implemented, perhaps this Resolution could have a requirement for Federal agencies to report on how well they are doing in implementing this Resolution.

Thank you once again for the opportunity to testify. I look forward to the continued interest of this Committee on the problem of government competition with small business. Of course, any resources at my disposal are available to assist you in your efforts to alleviate this problem. If there are any questions, I will be glad to answer them.

PRIME CONTRACTS STATISTICS

($'S ROUNDED TO NEXT HIGHEST BILLION)

DEPARTMENT OF DEFENSE

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
TOTAL DOD AWARDS	31.8	31.0	34.0	32.5	34.5	38.2	39.0	47.1	54.4	58.5	66.7
AWARDS TO SMALL BUSINESS	5.5	5.3	6.1	6.7	7.1	7.9	8.1	9.5	10.7	12.2	13.6
PERCENT TO SMALL BUSINESS	17.3	17.0	18.0	20.5	20.5	20.6	20.8	20.2	19.7	20.8	20.4
SET-ASIDE DOLLARS	1.5	1.5	1.6	1.7	1.6	2.3	2.3	2.9	3.4	4.1	4.8

CIVILIAN AGENCIES

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
TOTAL CIVILIAN/AGENCY AWARDS	10.1	10.0	9.8	10.5	12.0	16.4	15.7	20.8	24.4	23.9	24.4
AWARDS TO SMALL BUSINESS	2.0	2.4	2.6	2.7	3.3	4.8	4.3	6.5	8.5	7.4	7.9
PERCENT TO SMALL BUSINESS	19.3	23.7	26.0	25.7	23.0	29.2	27.5	31.3	34.6	31.0	32.4
SET-ASIDE DOLLARS	.39	.52	.64	.65	.74	.88	.89	1.4	1.7	1.7	2.4

TOTAL ALL AGENCIES

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
TOTAL FEDERAL PROCUREMENT	42.0	41.1	43.8	43.1	47.5	54.6	54.7	67.9	78.8	82.4	91.1
DOLLAR AWARDS TO SMALL BUSINESS	7.4	7.7	8.7	9.4	10.3	12.7	12.4	16.0	19.2	19.6	21.5
PERCENT TO SMALL BUSINESS	17.8	18.7	19.0	21.8	22.2	23.2	22.7	23.6	24.4	23.8	23.6
SET-ASIDE DOLLARS	1.89	2.02	2.24	2.35	2.34	3.18	3.19	4.3	5.1	5.8	7.2
% SET-ASIDE TO SMALL BUSINESS DOLLARS	25.9	27.3	26.7	27.0	22.5	25.0	25.7	26.9	26.6	26.6	33.6

Senator HAYAKAWA. I now call on Mr. Douglas Farbrother, Principal Director to the Deputy Assistant Secretary of Defense Facilities, Environment, and Economic Adjustment, Department of Defense.

STATEMENT OF DOUGLAS FARBROTHER, PRINCIPAL DIRECTOR TO THE DEPUTY ASSISTANT SECRETARY OF DEFENSE FACILITIES, ENVIRONMENT, AND ECONOMIC ADJUSTMENT, DEPARTMENT OF DEFENSE, WASHINGTON, D.C., ACCOMPANIED BY LT. COL. ALBERT L. RUSSELL, DIRECTOR, CONTRACT AND INTERSERVICE SUPPORT OFFICE, MANPOWER RESERVE AFFAIRS AND LOGISTICS, DEPARTMENT OF DEFENSE, WASHINGTON, D.C.

Mr. FARBROTHER. Thank you very much. It is a pleasure to be here this morning.

I have with me Lt. Col. Albert L. Russell from my office who is the Director of Contract and Interservice Support. He will be helping me answer any questions you have.

Senator HAYAKAWA. We shall enter your testimony in the record following your presentation, Mr. Farbrother. Please summarize it for us because of the time limitations.

Mr. FARBROTHER. Yes, sir, I will.

First, let me say that the Department of Defense supports your proposed joint resolution to clarify and reaffirm the basic policy of the Government to rely on competitive private enterprises to supply the needed goods and services.

Past experience indicates that contractor performance of commercial activities within the Department of Defense has been a responsive, dependable, and cost-effective means to accomplish the work. However, we also believe that the Government has a responsibility to the taxpayer and to our Federal employees. If we can do the job cheaper in-house with our own employees than by contract, we owe it to the taxpayers to do the job in-house.

We must also continue to provide fair treatment to our Federal employees by given them the opportunity to keep their job if they can do it efficiently, or by giving them priority consideration for placement in other Government positions when they are displaced by conversions to contract. We also require that contractors give our displaced employees the right of first refusal for their jobs.

In making the decisions of what defense workloads should be performed by contract or in-house resources, we follow the executive branch policies as outlined in OMB circular A-76. I will briefly explain how the program works. I think you will see that DOD is aggressively carrying out the policy of relying on the private enterprise system.

In the Defense Department, all of our commercial activities such as refuse collection, vehicle operations, and so forth, are being reviewed over a 5-year period to identify those required to be performed in-house for military essential reasons, or possibly if there is no satsifactory commercial sources available. The remainder will be subjected to a cost-comparision study to see whether it is more efficient to do it in-house or under contract.

The inventory we keep in our commercial and industrial-type activities for 1980 shows that about 17,000 in-house commercial activities are operated by DOD at an estimated annual cost of $17 billion. That involves about 735,000 work years. About 121,000 work years are reported for contracted activities. That cost is about $4 billion.

The inventory report does not include work that would never be considered for in-house performance such as the acquisition of major weapons systems. It does not include military construction programs which we do under contract. It does not include short duration one-time contracts.

Over the next 5 years, we estimate that about 20 percent of the inventoried in-house activities will be subjected to cost studies. Another 80 percent of these inventoried activities probably will be required to be performed in-house because of national defense reasons.

Let met take a minute to characterize that 80-percent estimate because I know it is the subject of some concern. That 80 percent is an estimate. It is a projection we are making of what is going to happen over the 5-year course of our review of all our commercial and industrial activities. We are only now into the first year of that review.

It is an estimate. We have not excluded 80 percent of our activities from competition. We are just looking at what is in the inventory, and by the nature of those things and our own conservative nature, being primarily defense managers first of all, we are guessing that as much as 80 percent will not be subjected to cost studies and we will need to keep those things in-house.

The nature of those activities is very much like the things we would contract. It is base operating support, vehicle maintenance, and that sort of thing. The thing that is different about that 80 percent is that it is being done primarily by military people.

The reason it is being done mostly by military people is that those people have a wartime mission. They are repairing vehicles now in peacetime. They would be deployed overseas to repair vehicles in wartime. We cannot lose that wartime capability in order to compete those activities and try to get a low price in peacetime. Our first priority has to be on the wartime issue.

In the past 3 years, we have completed 440 in-house versus contract-cost comparision studies. About 60 percent of these studies involving 11,000 work years resulted in decisions to convert to contract performance. We believe that this will save the U.S. Government about $90 million annually.

By the end of fiscal 1982, the military services plan to complete cost-comparison studies for another 20,000 civilian and military jobs the determine whether it would be more economical to do those on contract. We expect a similar level of studies to be conducted each year through 1987.

We are hoping that this year, or soon, Congress will adopt language similar to that which was proposed by the Senate Armed Service Committee this year to eliminate much of the burdensome congressional reporting requirements on converting small commercial activities to contract. I am referring here to the restrictions contained in section 502 of Public Law 96-342.

Under that provision, we have to do a detailed cost study of every activity whether it is a very large activity or a very small one and make certain reports to the Congress and certify that we are conducting the study properly. We want to do the studies properly, but this additional reporting requirement is very burdensome and takes a lot of our resources and management attention away from things that we could better spend it on.

We believe that the provisions that the Senate Armed Service Committee proposed to exclude from the congressional reporting requirements any activity that has 50 or fewer people would be a proper thing. That would relieve us of much of our reporting burden and administrative routine that we have to go through. It would be much in line with this administration's efforts to simplify the process. It is a very complicated process as the previous witness has described.

If we could free ourselves of some of that burden, we could then turn our attention to doing efficiency reviews on those activities that will not be subjected to cost comparisons. I am talking here about the estimated 80 percent of our activities.

As GAO has recommended, we want to do thorough efficiency reviews on those activities that are not going to come up for cost studies. It would be a great help to us if we were relieved of some of the administrative details and the statutory reporting requirements. We could turn our attention to that.

I will wrap up my comments now. I am prepared to answer any questions that you may have.

Senator HAYAKAWA. Thank you, Mr. Farbrother.

You make some good observations about section 502 of Public Law 96-342 as being burdensome and restrictive. Why is there opposition to eliminating this provision from the books?

Mr. FARBROTHER. I believe the opposition is mostly based on the concern of Federal employees that they will stand to lose a lot of jobs if this process is allowed to run free. The provision originates in the House Armed Service Committee. This year there was an attempt by that committee to make the provision even more restrictive. I believe that is not succeeding in conference.

Senator HAYAKAWA. You remind me of a problem of my own. Ever since I came to the Senate I decided to keep a journal of what I did here, but I keep so busy that I do not have time to keep up the journal. If I did keep up the journal, the reporting function that you speak of, I would not be able to do as much work on necessary legislative projects.

Mr. FARBROTHER. Precisely.

Senator HAYAKAWA. There is always a conflict between the work to be done and reporting about the work to be done, is there not?

Mr. FARBROTHER. That is right.

Senator HAYAKAWA. The more reporting that is required, the less work you get done, or the more people who have to do it. I cannot hire someone else to write in my journal so I am stuck. The journal is months behind.

Mr. FARBROTHER. I quite agree. While I was waiting to come up to the table, I was thinking: Now when I get back to the office, I am going to have to write a report of this hearing when I really should be doing some work.

Senator HAYAKAWA. That is a dilemma throughout the Government.

Mr. Farbrother. Yes, sir.

Senator Hayakawa. Can you provide the subcommittee with an idea of the types of commercial and industrial activities that have been converted by the Defense Department?

Mr. Farbrother. Yes. These are primarily the base support type activities: Laundries, vehicle maintenance, operation of the carpools, various transportation services, very mundane run-of-the-mill thing that any big base needs in order to operate.

Senator Hayakawa. Over the past 3 years, you say DOD has completed 440 cost-comparison studies, 60 percent of which resulted in decision to convert to contract performance. How many civilian or military jobs were eliminated as a result of these conversions?

Mr. Farbrother. There were about 2,500 military and 8,600 civilian jobs eliminated through those conversions.

Senator Hayakawa. That is quite a few; is it not?

Mr. Farbrother. Yes, sir.

Senator Hayakawa. What does the record show with respect to contractors offering Federal employees the right of first refusal for converted activities?

Mr. Farbrother. We believe the record is very good. We do not have complete data on that at this time. For example, at Fort Gordon, Ga., within the last several years almost all of the base operating support activities there were put out on contract. That eliminated 749 civilian jobs just at Fort Gordon; 355 of those civilians were placed in other Federal jobs. Of the remaining 394 that were involuntary separated, 380 of them were hired by the contractor.

Senator Hayakawa. There were very few who did not take advantage of the right of first refusal.

Mr. Farbrother. I am saying that they——

Senator Hayakawa. That they do not refuse.

Mr. Farbrother. They do not refuse. That is right. They do take advantage and keep their jobs.

Senator Hayakawa. That is interesting. This has minimum impact on unemployment.

Mr. Farbrother. That is right. Our experience has been that it has a very small impact on the net number of jobs in a local district.

Senator Hayakawa. In a September 30, 1981, letter to Secretary Weinberger, GOA states that, in 1980, the Defense Department received several hundred additional positions to better manage the A-76 commercial activities program. How are these positions being utilized? Is this again reporting on that which has to be done?

Mr. Farbrother. Much of it is, yes, sir. However, they are also being used to identify contract candidates, to perform the efficiency reviews, to make sure that the in-house activity is structured and doing the job as efficiently as possible before it is opened to competition, and to do the cost comparison studies themselves.

If we could get out of the reporting requirements and streamline this activity, we could free up some of those resources to make sure that we are being efficient on all of our activities, not just those that are going to be cost studied.

Senator Hayakawa. I am going to ask one last question. I invite Lieutenant Colonel Russell to join in the answer if he wishes to.

One fact about defense spending that causes great concern is cost overruns. I have often wondered whether these overruns may be the result of competitive bidding or whether it is the result of not enough competitive bidding. Would you care to comment on this?

Mr. FARBROTHER. My temptation is to let Colonel Russell answer. However, I believe that cost overruns are frequently a matter of bad estimating up front. Along with the contracting business of A-76, I am also responsible for construction contracts for new defense facilities. The problem we frequently have there is a bad estimate up front.

I will turn to Colonel Russell on our experience with A-76.

Colonel RUSSELL. Senator, we are very concerned about having a contractor, for example, come in and replace an in-house work force on what people would refer to as a buy-in, and, later on, escalate the price to whether it is no longer cost effective. We have done several things to try to make sure that that does not happen.

First of all, when we do go out for a solicitation, particularly under the A-76 guidelines, we require that the contractors provide us with second and third year price options so that we can hold them to the prices in the cost comparison process.

In addition to that, of course we encourage competition when those contracts are up and are ready to be resolicited. Those are some of the measures we take to make such that a buy-in does not happen.

Another thing we do is on an annual basis we task our defense audit service to go out and take a look at those activities that were converted to contract a year or more ago and also to look at the in-house activities that stayed in house, because they beat the contractor in the competition. The reason we ask them to do that is to make sure that there has not been an unjustified change, such as someone jacking up the price and taking advantage of the Government.

Fortunately, for the last two reports that we have received from the defense audit service, they have concluded that generally that is not happening. They have found a couple of isolated cases here and there where perhaps an in-house activity, after bidding and winning, has beefed up their manpower force in little bit. However, by and large, they have concluded that the contracts that we let back when the cost studies were completed are still more cost effective than the in-house operations.

Senator HAYAKAWA. Thank you very much, Colonel.

Senator Dixon, do you have some additional questions?

Senator DIXON. I have no questions, Mr. Chairman. I want to thank Mr. Farbrother and Colonel Russell for their testimony.

Senator HAYAKAWA. Thank you, gentlemen.

[The prepared statement of Mr. Farbrother follows:]

HOLD FOR RELEASE UNTIL DELIVERY
Expected at 10:00 am, November 4, 1981

STATEMENT OF DOUGLAS FARBROTHER
PRINCIPAL DIRECTOR
(FACILITIES, ENVIRONMENT, AND ECONOMIC ADJUSTMENT)
OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
(MANPOWER, RESERVE AFFAIRS AND LOGISTICS)
BEFORE THE
SUBCOMMITTEE ON ADVOCACY AND THE FUTURE
OF SMALL BUSINESS
SENATE SELECT COMMITTEE ON SMALL BUSINESS

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

THANK YOU FOR INVITING ME HERE TODAY. FIRST LET ME SAY THAT THE DEPARTMENT OF DEFENSE SUPPORTS YOUR PROPOSED JOINT RESOLUTION TO CLARIFY AND REAFFIRM THE BASIC POLICY OF THE GOVERNMENT TO RELY ON THE COMPETITIVE PRIVATE ENTERPRISE SYSTEM TO PROVIDE NEEDED GOODS AND SERVICES. PAST EXPERIENCE INDICATES THAT CONTRACTOR PERFORMANCE OF COMMERCIAL ACTIVITIES WITHIN THE DEPARTMENT OF DEFENSE HAS BEEN A RESPONSIVE, DEPENDABLE, AND COST EFFECTIVE MEANS TO ACCOMPLISH IMPORTANT WORK. HOWEVER, WE ALSO BELIEVE THAT THE GOVERNMENT HAS A RESPONSIBILITY TO THE TAXPAYER AND TO OUR FEDERAL EMPLOYEES. IF WE CAN DO A JOB CHEAPER IN-HOUSE THAN BY CONTRACT WE OWE IT TO THE TAXPAYER TO DO IT IN-HOUSE. WE MUST ALSO CONTINUE TO PROVIDE FAIR TREATMENT TO OUR FEDERAL EMPLOYEES BY GIVING THEM THE OPPORTUNITY TO KEEP THEIR JOB IF THEY CAN DO IT EFFICIENTLY, OR BY GIVING THEM PRIORITY CONSIDERATION FOR PLACEMENT IN OTHER GOVERNMENT POSITIONS WHEN THEY ARE DISPLACED BY CONVERSIONS TO CONTRACT. CONTRACTORS MUST ALSO BE REQUIRED TO GIVE AFFECTED FEDERAL EMPLOYEES THE RIGHT OF FIRST REFUSAL FOR JOBS UNDER CONTRACT.

IN MAKING DECISIONS ON WHAT DEFENSE WORKLOADS SHOULD BE PERFORMED BY CONTRACT OR BY IN-HOUSE RESOURCES, WE FOLLOW THE EXECUTIVE BRANCH POLICIES AND PROCEDURES IN OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-76. IN THE DEPARTMENT OF DEFENSE, WE REFER TO THE IMPLEMENTATION OF A-76 AS THE COMMERCIAL ACTIVITIES PROGRAM. IN EXPLAINING HOW THE PROGRAM WORKS I THINK YOU WILL SEE THAT DOD IS AGGRESSIVELY CARRYING OUT THE POLICY OF RELYING ON THE PRIVATE ENTERPRISE SYSTEM.

UNDER THE PROGRAM, ALL DEPARTMENT OF DEFENSE COMPONENTS ARE REQUIRED TO MAINTAIN AN INVENTORY OF ALL IN-HOUSE AND CONTRACTED COMMERCIAL ACTIVITIES, SUCH AS REFUSE COLLECTION, VEHICLE OPERATIONS AND MAINTENANCE, AUDIOVISUAL SERVICES AND OTHER BASE OPERATING SUPPORT TYPE FUNCTIONS. REVIEWS ARE REQUIRED OF ALL ACTIVITIES WITHIN A FIVE YEAR PERIOD TO IDENTIFY THOSE REQUIRED TO BE PERFORMED FOR MILITARY ESSENTIAL, NATIONAL DEFENSE REASONS AND THOSE FOR WHICH THERE ARE NO SATISFACTORY PRIVATE, COMMERCIAL SOURCES AVAILABLE. THE REMAINING ACTIVITIES MUST THEN BE SUBJECTED TO A COST COMPARISON STUDY TO DETERMINE WHETHER IN-HOUSE OR CONTRACT PERFORMANCE IS MORE ECONOMICAL.

THE FY 1980 INVENTORY REFLECTS THAT THE DEPARTMENT OF DEFENSE OPERATES ABOUT 17,000 IN-HOUSE COMMERCIAL ACTIVITIES AT AN ESTIMATED ANNUAL OPERATING COST OF $17 BILLION, INVOLVING ABOUT 735,000 WORKYEARS. ABOUT 121,000 WORKYEARS ARE REPORTED FOR CONTRACTED ACTIVITIES, INVOLVING ABOUT $4 BILLION, HOWEVER, THE INVENTORY REPORT DOES NOT INCLUDE CONTRACTED WORKLOADS

THAT WOULD NEVER BE CONSIDERED FOR IN-HOUSE PERFORMANCE SUCH AS MAJOR SYSTEMS ACQUISITION, MILITARY CONSTRUCTION PROGRAM CONTRACTS, AND ONE TIME CONTRACTS OF SHORT DURATION.

OVER THE NEXT FIVE YEARS IT IS ESTIMATED THAT ABOUT 15 to 20 PERCENT OF THE INVENTORIED IN-HOUSE ACTIVITIES WILL BE SUBJECTED TO COST STUDIES FOR POSSIBLE CONVERSION TO CONTRACT PERFORMANCE. THE OTHER 80 PERCENT OF THE INVENTORIED IN-HOUSE ACTIVITIES WILL PROBABLY BE REQUIRED TO BE PERFORMED BY MILITARY OR CIVILIAN PERSONNEL TO MEET NATIONAL DEFENSE NEEDS.

HOWEVER THIS 80% FIGURE IS ONLY AN ESTIMATE AND WE WON'T KNOW EXACTLY WHAT THE NUMBER IS UNTIL ALL THE ACTIVITIES ARE REVIEWED. AS THE DEFENSE DEPARTMENT, OUR FIRST PRIORITY IS TO BE READY MILITARILY. THEREFORE IN OUR REVIEWS WE FIRST DETERMINE WHICH COMMERCIAL ACTIVITIES MUST BE CONTINUED TO BE PERFORMED WITH MILITARY PERSONNEL IN ORDER TO SUPPORT OUR WAR PLANS AND TO INSURE THERE IS A SUFFICIENT POOL OF MILTARY PERSONNEL TO MEET OUR OVERSEAS ROTATION REQUIREMENTS. WE ALSO MUST MAINTAIN A READY AND CONTROLLED SOURCE OF TECHNICAL COMPETENCE AND RESOURCES FOR DEPOT LEVEL MAINTENANCE TO MEET MOBILIZATION AND SUSTAINED COMBAT EQUIPMENT READINESS REQUIREMENTS. WE ESTIMATE THAT ABOUT 500,000 WORKYEARS OF EFFORT WILL BE REQUIRED IN-HOUSE FOR THESE NATIONAL DEFENSE REASONS. AND SOME OF THOSE PERSONNEL ARE INTERMIXED IN ACTIVITIES WITH CIVILIANS WHO MAY NOT BE DIRECTLY TIED TO A NATIONAL DEFENSE REQUIREMENT. THEREFORE OUR ESTIMATE, THAT 20% OF COMMERCIAL

ACTIVITIES ARE SUITABLE FOR CONTRACT, IS BASED PRIMARILY ON ACTIVITIES THAT EITHER HAVE ALREADY BEEN IDENTIFIED AS SUITABLE FOR CONTRACTING OR THAT CONTAIN A PREDOMINATELY CIVILIAN WORKFORCE.

IN THE LAST THREE YEARS THE SERVICES HAVE COMPLETED OVER 440 IN-HOUSE VERSUS CONTRACT COST COMPARISON STUDIES. ABOUT 60% OF THOSE STUDIES, INVOLVING ABOUT 11,000 WORKYEARS, RESULTED IN DECISIONS TO CONVERT TO CONTRACT PERFORMANCE. IT IS PROJECTED THAT THOSE CONVERSIONS WILL SAVE THE U.S. GOVERNMENT ABOUT $90 MILLION ANNUALLY.

BY THE END OF FY 1982, THE SERVICES PLAN TO COMPLETE COST COMPARISON STUDIES FOR ABOUT 20,000 CIVILIAN AND MILITARY JOBS TO DETERMINE WHETHER IT IS MORE ECONOMICAL TO CONVERT TO CONTRACT OPERATIONS. WE ALSO EXPECT A SIMILAR LEVEL OF EFFORT EACH YEAR FROM FY 1983 THROUGH FY 1987.

HOWEVER, I HOPE THIS YEAR CONGRESS WILL ADOPT LANGUAGE SIMILAR TO THE SENATE ARMED SERVICES COMMITTEE PROPOSAL IN THE FY 1982 AUTHORIZATION BILL, TO ELIMINATE THE BURDENSOME CONGRESSIONAL REPORTING REQUIREMENTS ON CONVERTING SMALL COMMERCIAL ACTIVITIES TO CONTRACT. I AM REFERRING TO THE RESTRICTIONS CONTAINED IN SECTION 502 OF PUBLIC LAW 96-342. UNDER SECTION 502, A DETAILED COST STUDY MUST BE COMPLETED AND CERTAIN REPORTS AND CERTIFICATIONS MUST BE SUBMITTED TO THE CONGRESS BEFORE CONVERTING EVEN ONE JOB TO CONTRACT OPERATION. IN ADDITION TO INHIBITING AND DELAYING THE CONVERSION PROCESS, THE COST OF CONDUCTING DETAILED STUDIES FOR SMALL ACTIVITIES CAN APPROACH THE POTENTIAL FIRST YEAR SAVINGS. IF SMALL

ACTIVITIES, SAY THOSE WITH LESS THAN 50 CIVILIAN PERSONNEL, WERE EXCLUDED FROM THE COST STUDY AND REPORTING REQUIREMENTS, WE ESTIMATE THAT CONVERSIONS TO MORE COST EFFECTIVE CONTRACT OPERATIONS COULD BE SIGNIFICANTLY EXPEDITED. SUCH AN EXCLUSION WOULD ALSO ALLOW THE DEFENSE DEPARTMENT TO CONCENTRATE ITS COMMERCIAL ACTIVITIES MANAGEMENT EFFORT ON CONDUCTING THOROUGH REVIEWS OF LARGER FUNCTIONS WHERE THE POTENTIAL FOR IDENTIFICATION OF SUBSTANTIAL SAVINGS THROUGH COST COMPARISON PROCEDURES IS GREATEST.

FURTHER, SUCH AN EXCLUSION COULD ALSO ALLOW MORE CONCENTRATION ON THE PERFORMANCE OF EFFICIENCY REVIEWS TO IN-HOUSE ACTIVITIES. AS MENTIONED IN A RECENT GAO LETTER REPORT TO THE SECRETARY OF DEFENSE, ("EXPANDING THE EFFICIENCY REVIEW PROGRAM FOR COMMERCIAL ACTIVITIES CAN SAVE MILLIONS") THE GAO STATED THAT DOD HAS COMPLETED MORE EFFICIENCY REVIEWS OF COMMERCIAL ACTIVITIES THAN ANY OTHER FEDERAL AGENCY, HOWEVER, IT IS BELIEVED THAT SIGNIFICANT ADDITIONAL SAVINGS CAN BE REALIZED BY ALSO CONCENTRATING OUR EFFICIENCY REVIEW EFFORTS ON THOSE ACTIVITIES THAT ARE NOT SUITABLE FOR CONTRACT. AS PART OF THE IN-HOUSE VERSUS CONTRACT COST STUDY PROCESS, OMB CIRCULAR A-76 REQUIRES AGENCIES TO REVIEW IN-HOUSE COMMERCIAL ACTIVITIES TO INSURE THEY ARE ORGANIZED AND STAFFED FOR THE MOST EFFICIENT PERFORMANCE. DURING THESE EFFICIENCY REVIEWS, AGENCIES ARE TO DEVELOP AND APPLY PERFORMANCE STANDARDS THAT CLEARLY DESCRIBE ALL WORK REQUIREMENTS IN TERMS OF WHAT IS TO BE DONE. WE HAVE FOUND THAT IF DEVELOPED AND APPLIED PROPERLY, WORK STATEMENTS BASED ON PERFORMANCE STANDARDS CAN INCREASE PRODUCTIVITY AND REDUCE OPERATING COSTS BY ELIMINATING UNNECESSARY AND INEFFICIENT

WORK PRACTICES. AS A RESULT OF THIS COST STUDY AND EFFICIENCY REVIEW PROCESS, OVER 600 JOBS HAVE BEEN ELIMINATED SINCE FY 1979 IN ACTIVITIES THAT HAVE REMAINED IN-HOUSE. WHAT THIS MEANS IS THAT IN ADDITION TO THE SAVINGS REALIZED FROM THOSE ACTIVITIES THAT ARE CONVERTED TO CONTRACT, WE ARE ALSO REALIZING SIGNIFICANT SAVINGS FROM THOSE THAT STAY IN-HOUSE, JUST BY GOING THROUGH THE EFFICIENCY REVIEW AND COST STUDY PROCESS. AS A RESULT OF THIS SUCCESSFUL APPROACH WE HOPE TO APPLY IT TO ALL ACTIVITIES, EVEN THOSE NOT SUBJECT TO THE COST STUDY PROCESS.

IN SUMMATION, YOUR JOINT RESOLUTION PROVIDES THE MUCH NEEDED SUPPORT FOR OUR QUEST FOR ECONOMIES AND EFFICIENCIES. WE FIRMLY BELIEVE THAT COMPETITIVE PROCUREMENTS WILL FOSTER EFFICIENCY, ECONOMY, AND INCREASED PRODUCTIVITY IN THE FEDERAL GOVERNMENT.

MR. CHAIRMAN, I HOPE THAT MY COMMENTS HAVE BEEN USEFUL IN EXPLAINING THE DEPARTMENTS COMMERCIAL ACTIVITIES PROGRAM, AND OUR VIEWS ON THE JOINT RESOLUTION.

I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

THANK YOU

Senator HAYAKAWA. We next have a panel of Mr. Brian Usilaner, Associate Director, National Productivity Group, Accounting and Financial Management Division, General Accounting Office; Mr. John F. Galuardi, Acting Commissioner, Public Building Service, GSA; and Mr. James Netterstrom, president, Ship Shape Maintenance Co., Washington, D.C.

Mr. Usilaner, I wonder if you would summarize your testimony. Your full testimony of course will go into the record following this panel's presentation.

I welcome Mr. Galuardi and Mr. Netterstrom to the hearing.

Mr. Netterstrom, I think you have the most wonderful name from a maintenance company, Ship Shape.

Mr. NETTERSTROM. Thank you, sir.

Senator HAYAKAWA. It is an inspired name for the company.

Mr. NETTERSTROM. I wish we were doing as well as the name.

Senator HAYAKAWA. Well, you have something to aspire to then.

Mr. Usilaner?

STATEMENT OF BRIAN L. USILANER, ASSOCIATE DIRECTOR, NATIONAL PRODUCTIVITY GROUP, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C.

Mr. USILANER. Mr. Chairman, I am happy to be here this morning. I am sure you know that GAO has done a lot of work in this area of A-76, cost comparisions, and the use of private contractors to handle Government commercial activities.

In September 1978, we recommended that Congress endorse a national policy of reliance on the private sector for commercial activities. We reiterated that recommendation in June of this year.

This morning I would like to summarize a report entitled "GSA's Cleaning Costs Are Needlessly Higher Than in the Private Sector."

Senator HAYAKAWA. The report to the Congress by the Comptroller General is the report you refer to?

Mr. USILANER. Yes, sir.

As I said, there were two other reports where we reiterated our recommendation of the national policy, but this one was directed toward GSA's cleaning services.

The importance of productivity improvement to our economy and to cost reduction efforts has become a widely recognized fact. In the abstract, the subject need hardly be discussed.

However, as it applies to specific Government programs and private sector firms, productivity improvement retains the need for focused attention. A case in point is this report on GSA's cleaning program.

The report on which my statement is based is one of a series of high-yield studies that we have made using the approach of comparing certain Government functions with like functions performed by the private sector. By examining Government productivity in a particular area, in this case the custodial program, and comparing that to private sector performance, we are able to identify where specific improvements can yield significant cost savings.

GSA has three ways of accomplishing cleaning: its in-house employees, contracting out, and having owners of Government-leased space provide the cleaning. The third mode is performed solely by the private sector with little Government involvement. Cleaning in all cases is to be done by commercially equivalent GSA specifications.

In our review we compared the cost of productivity of cleaning done by all three methods for a sample of office buildings in four regions. We found that GSA had not kept its cost for this activity nearly as low as possible.

Our comparision of fiscal 1980 cleaning costs in the four regions showed that GSA was paying over 50 percent more to clean office space with its own staff then with contractors, and almost twice what its landlords paid to clean leased Federal space. We identified two major reasons for these extreme diferences: wages and productivity.

Regarding wages, both GSA and its contract cleaners pay more than do GSA's landlords. GSA, however, has little or no control over wage rates. We have reported in the past on the need for changes in the Federal blue-collar wage law, and on the contracting side, we will soon complete a study of the Service Contract Act.

Because we are separately studying wages, this report confined our custodial review primarily to the subject of productivity.

The other major cause of the wide range in cleaning costs is the varying productivity performance achieved by GSA's three cleaning modes. According to production rates we compiled, the agency's in-house staff cleaned an average of 10 percent less area per staff-hour than contractors and an average of 17 percent less than custodial firms cleaning for landlords.

GSA did not have good comparable data on cleaning quality, but agency officials acknowledged that most custodial contractors clean as well or better than the in-house staff.

An important causal factor contributing to GSA's low in-house productivity is its failue to maintain up-to-date staffing standards. GSA's standards were developed in the mid-1960's and have changed very little since. In our opinion, these standards are seriously outdated.

Because of the higher cost of cleaning with its in-house staff, GSA is paying several million dollars more per year than necessary. We estimate that in the four regions we studied, GSA could have saved approximately $16 million during 1980 had it contracted out for cleaning.

I will now discuss actions that are needed to reduce GSA's cleaning costs. Executive branch policy contained in circular A-76 requires GSA to contract for cleaning when it is more economical than in-house performance. It provides guidelines for comparing costs.

The policy also encourages GSA to organize and staff its in-house operations for the most effective performance before making such a comparision. OMB has specified that GSA was to have completed the cost comparisions by September 1982.

Despite this requirement, we found that GSA had taken little action to reduce its in-house cleaning costs. As of our review, which was completed this past summer, it had neither issued an order implementing A-76 nor completed any comparative cost studies.

Instead of actively implementing A-76, we found that GSA is slowly converting to contract cleaning as attrition reduces its in-house custodial work force. At the present rate, we estimated this conversion would take about 15 years. During that period, GSA could spend about $250 million more in cleaning than would be necessary.

Given the magnitude of the costs involved, we do not believe GSA can afford the luxury of continuing to act so slowly. It should complete the cost comparisions required by A-76 as rapidly as possible. To facilitate this action, we encourage GSA to explore with OMB a streamlined approach in applying A-76 to cleaning.

I now turn briefly to GSA's contract operations. We found that although GSA's contract cleaners are less costly and more productive than in-house staff, contractors, due to GSA's restrictions, are not quite as productive as custodial firms cleaning for GSA landlords.

GSA can foster greater productivity and thus reduce costs of cleaning by eliminating its requirements that contractors clean during the day, No. 1, and, No. 2, that contractors use a minimum number of staff hours. GSA uses minimum staff hours in an attempt to insure that contractors provide acceptable quality. Instead of this mechanism, we believe that GSA should establish effective preaward surveys and a good inspection system to accomplish the same thing.

GSA has a real need to demonstrate its intention to forsake old ways and strive for positive change, especially in this area. We are pleased by the new GSA administrator's receptivity to our report. We hope to observe soon the corrective actions that are needed.

In conclusion, we believe that OMB Circular A-76, implemented properly by Government agencies, can be an effective tool for improving productivity and reducing the cost of Government operations. We at GAO will continue to monitor the progress that GSA and other agencies make in using this as a management tool.

Thank you, Mr. Chairman.

Senator HAYAKAWA. Thank you, Mr. Usilaner.

Would you care to follow up immediately, Mr. Galuardi?

STATEMENT OF JOHN F. GALUARDI, ACTING COMMISSIONER, PUBLIC BUILDINGS SERVICE, GENERAL SERVICES ADMINISTRATION, WASHINGTON, D.C.

Mr. GALUARDI. I appreciate the opportunity to appear before your committee today to discuss Government competition and to outline GSA's experiences in this area.

GAO correctly pointed out that in may instances our cleaning costs are too high. How much higher they are than private industry standards is a matter of debate, but we do know they are too high.

Mr. Gerald P. Carmen, the Administrator of GSA, has placed high priority on A-76 review of all GSA services. He believes the Government should have its services performed at the lowest possible cost. He feels that this can best be done by utilizing the competitive process on a low-bid basis from all segments of the industry and Government.

We intend to conform with the socioeconomic programs established by law in the most cost-effective manner. For example, the

GAO report deals with higher costs resulting from energy considerations of day versus night cleaning.

We will compare energy savings with other costs factors in making overall cost determinations. The solution here is simple. We balance cleaning costs against energy costs resulting from nighttime operations and follow whichever path will result in the least cost to the taxpayers.

Another concern in the GAO report was the increased cost of specifying a minimum number of work hours in contracts. The solution here is to monitor contract performance as well as the number of hours spent on the job.

We intend to consult with the building owners and managers associations and others in the private sector to establish methods and guidelines that will provide easily understood and accurate comparisons of efficiencies and costs.

We agree that implementation of the Office of Management and Budget Circular A-76 is an important tool in reducing our cost of operation as well as emphasizing the general Federal policy of obtaining services. Under our new administrator, we are vigorously pursuing accelerated A-76 implementation.

In this regard, GSA has already increased the portion of our cleaning workload that is performed by commercial contractors from 14 percent in 1973 to 60 percent in 1981. In the year ending September 30, 1981, over 700 of our buildings, representing 71 million square feet of space, were contract cleaned at a cost of over $83 million.

Under the new administration, however, we have instructed our regional offices, under the guidelines of A-76, to proceed immediately to convert cleaning activities with an annual cost of $100,000 or less to contract where economically feasible. There are approximately 545 buildings with 12.4 million square feet of space in this category.

All cleaning activities over $100,000 have been scheduled for a cost comparison before September 30, 1982. We anticipate that a significant portion of the current in-house cleaning activities will be converted to contract on the basis of lower total costs. The increased contracting out by GSA for janitorial services will provide approximately $75 million in additional revenue to the business community.

As you know, GAO has recommended that we allow large contractors to bid on some cleaning contracts, especially for large buildings. We are exploring that possibility within the framework of the law. The net effect of all these actions should still be to increase the number of awards to small businesses. We at GSA feel that vigorous competition within the constraints of the law is the best solution to combating the rising costs of cleaning.

The biggest aid to increasing small business involvement is to simplify the rules and regulations so that it will be easier and more profitable for them to do business with the Federal Government.

In summary, you can expect to see some major reforms in GSA's cleaning operations. Businessmen will have an increased opportunity to compete for Government contracts. We intend to spend the taxpayers' money in a prudent and businesslike manner. We welcome the chance to make our cleaning operations as effective and competitively priced as in private industry.

I thank you for your invitation to testify today and will be glad to respond to any questions.

Senator HAYAKAWA. Thank you, Mr. Galuardi.

We will proceed next to hear from Mr. Netterstrom of Ship Shape Maintenance Co. of Washington, D.C. then I will address my questions to the entire panel.

STATEMENT OF JAMES S. NETTERSTROM, PRESIDENT, SHIP SHAPE MAINTENANCE CO., INC., WASHINGTON, D.C.

Mr. NETTERSTROM. Thank you, Mr. Chairman.

My name is James S. Netterstrom, CBSE. I am the owner and president of Ship Shape Maintenance Co., Inc., a Washington, D.C., building service contracting firm.

I am also president-elect of the Building Service Contractors Association International with headquarters in Vienna, Va. This statement is presented by the Building Service Contractors Association International. BSCA International has 1,300 members from 33 countries, 90 percent of which are located in the United States. Members are companies primarily engaged in providing cleaning services on a contract basis.

The building service contracting industry is made up mostly of small businesses. Research by our association finds the median gross sales volume of member companies is $800,000. It is a labor intensive industry employing primarily part-time labor from among the disadvantaged low-income sector.

BSCA International strongly supports OMB Circular A-76. We read with much regret about the passage of section 602 of the compromise agreement on the Veterans' Compensation Amendments of 1981. There seems to be no basis of fact to justify granting the Veterans' Administration such a delay in complying with Circular A-76.

Our association concurs in principle with the Comptroller General's report to the Congress, "GSA's Cleaning Costs Are Needlessly Higher Than in the Private Sector."

Specifically, BSCA International recommends. Eliminate minimum staff hour requirements; institute preaward screening surveys of low-bid contractors; require and enforce performance bonds; conduct onsite cleaning inspections with qualified, trained inspectors; provide for multiyear contracts; open contracts to both small and large businesses; expedite the cost studies required by Circular A-76; eliminate the requirements for wage determinations, or at last revise the methods used to determine the minimum wage specified; allow flexibility in work scheduling to permit night cleaning.

I am ready to answer any questions or give any examples I might have.

Senator HAYAKAWA. Thank you, Mr. Netterstrom.

The work that all three of you are talking about is a matter of great interest to me because there are tasks which do not require an MBA or a Ph. D. These are tasks that can be undertaken by people of modest education, or no education at all in some cases. Nevertheless, they are a means by which the unskilled or those of modest skills can acquire dignity and their first step on, the lowest rungs of the economic ladder; a means by which they can go up in the world.

As a child of immigrants and being acquainted with other immigrants and their histories, we all have to start somewhere. You people are in the business of providing that kind of work that gives people a start. You no doubt hire people of minority groups and recent immigrant groups. Is that not correct?

Mr. NETTERSTROM. That is correct.

Senator HAYAKAWA. And non-English speaking workers and so on?

Mr. NETTERSTROM. That is correct.

Senator HAYAKAWA. All this kind of work represents this whole level of people making a start out of the lower classes and into the self-respecting earning classes that pay their own rent, pay for their own food, and look the world in the eye. This is why I am very much interested in the opportunities provided by this kind of business; business where people get a start in American life.

Mr. Usilaner, do you have an estimate of the total amount of money GSA could save if it contracted for cleaning services now being performed by its own employees?

Mr. USILANER. For the four regions that we studied, we estimated about $16 million. We made a guesstimate at the time that if you projected that to the other regions it would be about $32 million, at least $32 million.

Senator HAYAKAWA. Do you have a comment, Mr. Galuardi, on the same question?

Mr. GALUARDI. I do not think so, Mr. Chairman. I think GSA has taken the position that the finding that GAO has found in this report was our own findings, that it is cheaper to clean by contract than it is by in-house forces.

I might explain a little bit of the management process that GSA had used prior to this GAO report. The A-76 process is not a new process. It has been around since the 1960's.

Senator HAYAKAWA. Yes, but it has been virtually ignored.

Mr. GALUARDI. They changed the rules in 1979 a little, but the history of what GSA has done is to attempt to contact out, and our record does show that over the years we have moved slowly into more contracting versus in-house.

We thought we were assuming a rather humane approach to the thing in that what we did was, when people left the Government service, we did not fill their job. Then we turned those jobs over to a contractor. We did it mainly in the large metropolitan areas because there we had the opportunity of having more than one building in a single community to be able to shift the workers around until we could slowly retrench and reach the point where ultimately you would then contract out everything that is in that particular city. Over the years that was the attitude of approach.

In 1979, however, and with the current administration's approach toward contracting out, we are now biting the bullet. What we will do is fire or RIF the Federal employees on all of the cases where there is a cost under $100,000. We will turn these over to contract. This is a result of a change in the management toward the contracting out policy.

Senator HAYAKAWA. Is the administrator of GSA, Mr. Gerald Carmen, an appointee of the new administration?

Mr. GALUARDI. Yes, he is.

Senator HAYAKAWA. He is partly responsible for carrying out this entire change in plan?

Mr. GALUARDI. Yes, he is.

Senator HAYAKAWA. Mr. Netterstrom, tell me about section 602 of the Veterans' Compensation Amendments of 1981 and your objections to it.

Mr. NETTERSTROM. Sir, from what I understand, the Veterans' Administration has made a plea to escape following circular A-76, such as contracting out their hospital cleaning or food services or what have. As I understand it, their basis of copping out, if you will, is that the Congress or the Office of Management and Budget did not allow them $29 million which it took to do the cost comparision studies. In my opinion, if it took $29 million, I will contract for a piece of that.

Senator HAYAKAWA. Does anyone else have a comment on that particular provision?

Mr. USILANER. I understand there are going to be hearings held tomorrow on this.

Mr. NETTERSTROM. That is correct.

Senator HAYAKAWA. I am glad to hear that. Under whose auspices is that hearings being held?

Mr. USILANER. The Senate Veterans' Affairs Committee.

Senator HAYAKAWA. We will try to keep track of what is learned there.

You believe, do you not, Mr. Netterstrom, that you or other BSCA members perform cleaning contracts for less than it costs GSA employees to perform the same work?

Mr. NETTERSTROM. There is no question that we do, except sometimes when we get——

Senator HAYAKAWA. You say you have no doubts in answer to that?

Mr. NETTERSTROM. Yes. There is no doubt that the contractor does perform the work cheaper than does GSA, providing of course that you do not get stuck with a higher minimum man-hour contract. All you are doing there is putting man-hours in and the man-hours are not doing anything and paying a wage rate due to the wage determination that might be higher than GSA's. That is entirely possible.

Senator HAYAKAWA. Tell me about the man-hour requirements. How do they work?

Mr. NETTERSTROM. In their janitorial contracts, GSA has issued a minimum man-hour requirement. In other words it says that you shall furnish daily or monthly so many man-hours as a minimum to perform the tasks described in the contract. Oftentimes, you can perform the task literally with less man-hours.

As an example of that, in 1976 the Imperial Building at 1441 L Street NW., was occupied by the SBA if I am not mistaken. The owner was providing the cleaning of that building for a cost of, I believe $62,000 a year. The owner renegotiated the lease with GSA so that GSA had to provide the cleaning services. We got the job for a cost of $109,000 a year. On September 30 it was $62,000 and on October 1 it went up to $109,000.

We performed the cleaning services for several years to the satisfaction of GSA but working for the owner using approximately 62.5 hours a day. Under the GSA specifications we had to furnish 81 man-hours a day. We were paying $2.70 an hour, but the wage determination required us to pay $3.58 an hour, plus 21 cents an hour in health and welfare benefits. That was the difference in cost.

I think that illustrates three things as far as the GAO report. One, yes, owners are providing services at cheaper than the Government is providing services by way of contractors. That is due to the artificial costs we are forced to pay.

Mr. **Usilaner**. In essence, it takes away the incentive for the contractor to improve his productivity.

Mr. **Netterstrom**. That is true.

For the last 9 months in this region, GSA has gone away from minimum man-hour contracts. However, today at 2 p.m., there is a new minimum man-hour contract going to be open for bid.

Senator **Hayakawa**. Are these minimum man-hour contracts an act of humanitarianism to provide more employment? What is the purpose of that?

Mr. **Galuardi**. I would like to explain.

Senator **Hayakawa**. Please, sir.

Mr. **Galuardi**. The problem of course is not as simple as it is always made out to be. The problem is that you have to balance two things. One is the cost of the services being performed. The other is getting the delivery of the services being performed.

I am not too familiar with the Imperial Building, but if we told the lessor to stop providing the cleaning and we picked it up ourselves, in my judgment it would have been because we were unsatisfied with the services being delivered by that lessor. We do not want to take over any operations from lessors if we do not have to. We prefer the lessor to provide it because we do feel, as GAO has found here, that the lessor can provide the cleaning services at a lesser cost.

One of the reasons is obviously because of the Federal laws which do not put these wage rate determinations upon the lessor but do put them upon any contract that the General Services Administration or any other Government agency has to enter into.

With regard to the minimum man-hours part of it, this was an attempt by GSA to work out a system whereby we could be assured of performance by using a technique using performance standards to determine how often things should be done in the building, how long does it take to do each of the particular items, and adding up then in a month how many people do you think you should have in that building to do that work.

In the contracts earlier on, we said we wanted 100 percent of a minimum man-hours using that performance standard. We did acknowledge that some private corporations can do it more economically so we dropped it to 90 percent. We found out they could perform still faster so we dropped it to 80 percent.

Currently, under our minimum standards, we are saying that the contractor must show us that he has 80 percent of these man-hours at the building. We have to take in assumption that if they are at the building they are going to be working and they are going to give us the quality of cleaning that we deserve and are willing to pay for.

We had an example of one whereby we switched from the minimum man-hours down to an incentive. They told me under the minimum man-hours we had 35 employees in that building. Immediately afterward, when we shifted to the other type of contract, we had five.

I find it kind of hard to believe that you can clean a building adequately with five when it had been done with 35. What it meant was we had to improve our ability to be able to enforce the contract. The contractor then had to bring his number back up again.

I am only demonstrating here that there is a reason why we have the minimum man-hours. We are not exactly in love with minimum man-hours. It has just been a technique whereby we have attempted to get some sort of performance out of the contractor.

There are other ways. The national capital region has experimented with dropping minimum man-hours out. The costs have dropped. I think that they have been fairly successful so far in that we have not had too many problems with the contractors recently in getting performance.

I think some of the things that Mr. Netterstrom has recommended here are things that are probably going to be helpful to us, like the preaward screening of low-bid contractors. That is an important feature with regard to perhaps keeping people out who buy in at a low price on a contract and then are not capable of performing, which gives the Government a difficult obstacle to overcome and try to terminate. We have absolutely no problem with those people who are excellent contractors.

Senator HAYAKAWA. Thank you very much, Mr. Galuardi.

Do the other two panelists have any further comments?

Mr. USILANER. I just want to underscore the comment you made earlier that one of the problems that GAO has noted in its past reports has been the sporadic and uneven implementation of A-76. This is why we had advocated in our past reports that Congress pass a national policy such as the one you are proposing.

Senator HAYAKAWA. Thank you very much, gentlemen.

[The prepared statements of Mr. Usilaner, Mr. Galuardi, and Mr. Netterstrom follow:]

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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D. C.

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STATEMENT OF
BRIAN L. USILANER
ASSOCIATE DIRECTOR
ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

BEFORE THE
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON ADVOCACY AND THE FUTURE
OF SMALL BUSINESS

UNITED STATES SENATE

ON

THE GENERAL SERVICES ADMINISTRATION'S CLEANING PROGRAM

Mr. Chairman and members of the subcommittee:

We are pleased to appear before you today to summarize the findings of our August 1981 report entitled "GSA's Cleaning Costs Are Needlessly Higher Than In The Private Sector." With the Chairman's permission, I would like to submit the full report for the record.

The importance of productivity improvement to our economy and to cost reduction efforts has become a widely recognized fact. In the abstract, the subject need hardly be discussed. However, as it applies to specific Government agencies' programs and private sector firms, productivity improvement retains the need for focused attention. A case in point is the General Services Administration's (GSA's) cleaning program.

The report on which my statement today is based is one of a series of high-yield studies that we have made using a similar approach; namely, comparing certain Government functions with like functions performed by the private sector. By examining Government productivity in a particular area--in this case GSA's custodial program--and comparing that to private sector custodial performance, we were able to identify where specific improvements could yield significant cost savings.

GSA is responsible for cleaning general purpose Government-owned and leased buildings. The agency has three ways of accomplishing this task: (1) its in-house employees, (2) contracting out, and (3) having owners of Government-leased space provide the cleaning. The third mode is performed solely by the private sector with very little Government involvement. Cleaning in all cases, however, is to be done to similar "commercially equivalent" GSA specifications.

In our review we compared the cost and productivity of cleaning done by all three methods for a sample of office buildings in four GSA regions (Washington, D. C., Boston, Atlanta, and Chicago). Our sample included at least 10 percent of the space cleaned by each method in each region.

GSA's custodial function is an example of a Government "commercial or industrial activity," which means it is operated and managed by a Federal executive agency, is a service needed regularly, and is obtainable from a private source.

As of February 1981, Office of Management and Budget (OMB) data indicated that over 11,000 such activities were being operated by about 400,000 Federal employees at an estimated cost approaching $19 billion annually. OMB Circular A-76 contains important requirements about these activities, and I will return to this subject shortly.

Regarding GSA's cleaning program, the agency has not kept its costs for this activity nearly as low as possible. Our comparison of fiscal 1980 cleaning costs in four GSA regions showed that, overall, GSA was paying over 50 percent more to clean office space with its own staff than with contractors, and almost twice what its landlords paid to clean leased Federal space.

(Average annual cleaning costs per square foot for each mode of cleaning in the four regions are shown in appendix I of this statement.)

We identified two major reasons for these extreme differences in cleaning costs: wages and productivity.

Regarding wages, both GSA and its contract cleaners pay more than do GSA's landlords. GSA, however, has little or no control over wage rates. In accordance with law, the Office of Personnel Management sets wages for GSA's custodians, and the Department of Labor sets the wages paid by contractors. We have reported on the need for changes in the provisions of the Federal blue collar law that causes Federal wage rates to exceed local prevailing rates. On the contracting side, we will soon complete a study of the Service Contract Act and will report our findings to the Congress.

Because we are separately studying wages, we confined our custodial review to the subject of productivity and other issues affecting cleaning costs.

The other major cause of the wide range in cleaning costs is the varying productivity performance achieved by GSA's three cleaning modes. According to production rates we compiled in four GSA regions, the agency's in-house staff cleaned fewer square feet per staff hour than either its contract cleaners or custodial firms cleaning for its landlords. The in-house staff cleaned an average of 9.8 percent less area per staff hour than contractors, and an average of 17 percent less than custodial firms cleaning for landlords. GSA did not have good comparable data on cleaning quality, but agency officials acknowledged that most custodial contractors clean as well or better than the in-house staff.

An important causal factor contributing to GSA's low productivity is its failure to maintain up-to-date staffing standards based on the latest technology in cleaning methods, supplies, and equipment. Standards are important since they reflect management's expectation of performance. GSA's standards were developed in the mid-1960s and have changed little since. In our opinion, the standards are seriously outdated.

(Average hourly production rates for the three modes of cleaning are given in appendix I of this statement.)

Because of the higher cost of cleaning with its in-house staff, GSA is paying several million dollars more per year for cleaning than necessary. We estimate that in the four regions we studied, GSA could have saved approximately $16 million during 1980 had it contracted for cleaning being done by its own custodians.

I will now discuss actions that are needed to reduce GSA's cleaning costs. Federal executive branch policy contained in OMB Circular A-76 would require GSA to contract for cleaning when it is more economical than in-house performance, and it provides guidelines for comparing costs to make such determinations. (The policy also encourages GSA to organize and staff its in-house operations for the most effective performance before making a cost comparison.) OMB specified that GSA was to have completed the cost comparisons by September 1982. (See app. II.) Despite this requirement, as of our review GSA had taken little action to reduce its in-house cleaning costs. It had neither issued an order implementing Circular A-76 nor completed any comparative cost studies.

Instead of actively implementing A-76, GSA is slowly converting to contract cleaning as attrition reduces its in-house custodial work force. At the present rate, this conversion would take about 15 years. During that period, GSA could spend about $250 million more for cleaning than would be necessary if it acted to improve the productivity of its in-house staff and contracted for cleaning where its in-house staff is not cost competitive.

Given the magnitude of the costs involved in the cleaning area, we do not believe GSA can afford the luxury of continuing to act so slowly. It should complete the cost comparisons required by A-76 as rapidly as possible. To facilitate this action, we encourage GSA to explore with OMB a streamlined approach in applying A-76 to cleaning. In locations where GSA has actual experience and cost data readily available for comparison, formal A-76 analyses may be more burdensome than beneficial.

I now turn briefly to GSA's contract operations. Here again our public-private sector comparison approach was most productive. We found that although GSA's contract cleaners are less costly and more productive than the in-house staff, the former, due to GSA restrictions, are not quite as productive as custodial firms cleaning for GSA landlords. GSA can foster greater productivity and thus reduce the costs of cleaning done on contract by eliminating, where possible, its requirements that contractors clean during the day and use a minimum number of staff hours. GSA's use of minimum staff hours is an attempt to ensure that contractors provide acceptable cleaning quality. Instead of minimum hours, GSA should establish (1) effective preaward surveys to identify and preclude the awarding of contracts to unreliable contractors and (2) a good inspection system to control quality.

Other actions--less directly related to productivity--by which GSA can reduce cleaning costs are to:

--Use renewal options in contracts, at least on a pilot basis.

--Allow large contractors to bid on some cleaning contracts, especially those for larger buildings.

--Require that cleaning contracts with disadvantaged businesses be obtained at a cost reasonably close to that of competitively bid contracts.

The General Services Administration has a real need to demonstrate its intention to forsake old ways and strive for positive change. We were pleased by the new GSA Administrator's receptivity to our report, and we hope to observe soon the corrective actions that are needed.

In conclusion, we believe that OMB Circular A-76, implemented properly by Government agencies, can be a most effective tool for improving productivity. We at GAO will continue monitoring the progress that GSA and other agencies make in using this tool, and one way we will do this is with our public-private sector comparison approach.

COSTS AND PRODUCTIVITY FOR THE THREE MODES OF CLEANING USED BY GSA

A. CLEANING COSTS

	Average annual costs per BOMA square foot (note a)				
	Boston	Atlanta	Chicago	Washington, D. C.	Weighted average
In-house staff (note b)	$1.19	$ 1.05	$1.25	$1.20	$ 1.18
Contractors (note c)	.75	.67	.91	.72	.73
Landlords (note d)	.58	.47	.88	.57	.63

a/ BOMA square feet is a standard method of floor measurement used by the Building Owners and Managers Association, International. It includes all areas within outside walls except space not actually available to the tenant for furnishings or personnel. Where other types of measures are used by GSA, we converted them to BOMA square feet.

b/ Includes wages plus premium pay and benefits (11%) for all field office personnel. Excludes headquarters and region program direction costs and expenditures for major equipment.

c/ Total contract costs including profit. Does not include GSA contract administration costs, estimated at 4 percent.

d/ Total costs cited in contracts or by landlords. Excludes landlord overhead for contract administration or direction of in-house cleaning staff.

The above figures are not perfect comparisons. For example, wages differ by region and by location within region, and regions vary in staffing GSA-cleaned buildings to GSA standards. Also, some buildings because of their design and use are more difficult to clean; thus more staff may be required to clean them. The tasks performed by custodians differ somewhat and, to the extent possible, we adjusted for this. Notwithstanding these variances, the figures reflect the relative difference in cost among GSA's in-houses staff, its contractors, and its landlords, that persisted at each of the regions.

B. CLEANING PRODUCTIVITY

	Average cleaning productivity rate (note a)			
	Boston	Atlanta	Chicago	Washington, D.C.
	---------------- (sq.	ft. per hr.)-----------		
In-house staff	1910	2157	2213	2196
Contractors	2157	2410	2428	2474
Landlords	2700	2764	b/ 2463	2566

a/ These rates were determined using direct labor hours and BOMA square feet.

b/ Productivity rates may be limited by a union agreement in Chicago that firms cannot decrease the number of janitors in a building without union approval.

These rates must be considered reasonable approximations rather than precise measures of performance. Available data were not precise, and for us to accumulate such data on our own was not cost effective. Nonetheless, the rates we compiled reflect the relative differences in existing productivity rates.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 8 1981

Mr. Ray Kline
Acting Administrator
of General Services
Washington, DC 20405

Dear Mr. Kline:

One of the major goals within this Administration centers on maximizing the efficient expenditure of funds. OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," provides you with one of the necessary tools to achieve this goal. This Administration strongly supports the general policy of reliance on competitive private enterprise to supply the products and services needed by the Government. Through proper and effective implementation of the Circular you will be able to achieve economies and efficiencies in operating commercial-industrial type activities by:

- Determining the least cost method of providing essential services (contract or in-house).
- Streamlining existing Government organizations ensuring they are organized and staffed for the most efficient performance.
- Reducing long-range fiscal obligations through reductions in the Federal workforce when cost comparisons show a contract operation is more cost effective.
- Enhancing productivity through the development of measurable job standards.

The Circular provides that when private performance of commercial or industrial activities is feasible and no overriding factors require in-house performance, a rigorous comparison of contract costs versus in-house costs will be made, using the Circular's Cost Comparison Handbook, to determine whether the work will continue to be performed by in-house personnel or converted to a contract operation. The Circular contains several provisions that give appropriate consideration to affected Federal employees. Among the more significant ones are that:

- Existing in-house activities will not be converted to contract performance on the basis of economy unless it will result in a savings of at least 10 percent of the estimated Government personnel costs for the period of the comparative analysis; and
- Federal employees displaced as a result of the conversion to contract performance will be given the right of first refusal for employment openings in the contract operation.

I recently reviewed your implementation of Circular A-76 and note that it has been in a vacuum for almost two years. I understand that one of the reasons the Circular has not been implemented within your Agency is due to the lack of a formal implementing order. Although such an order is not required by the Circular, our primary concern is that since the effective date of the Circular in all agencies was May 1, 1979, your agency has not reviewed a single in-house activity for possible conversion to contract performance. This gravely concerns us in view of the obvious savings that can be effected through reliance on the private sector.

In reviewing your inventory, I believe that the opportunity exists for you to conduct OMB Circular A-76 cost comparison studies on the four functions listed below which comprise over 13,000 personnel positions. These functions are:

Guard Services	3,000
Custodial	5,000
Building Maintenance	4,000
Motor Vehicle Operations and Maintenance	1,000
Total	13,000

Therefore, these functions shall be scheduled for cost comparison studies in FY 1981 and completed by September 1982. Accomplishment of these studies in that timeframe will move us closer to the realization of this Administration's goals. I look forward to your response regarding your specific plans to review the above listed functions.

One of the actions required to ensure uniform implementation of the Circular in the civilian agencies is the modification of the Federal Procurement Regulation (FPR). Your assistance is requested in publishing appropriate clauses and contract provisions thereby enacting uniform procurement procedures. The recently published draft Federal Acquisition Regulation A-76 coverage should be the basis of the procedures incorporated into the FPR. We would appreciate this being accomplished within 60 days.

Both the Circular and other instructions, limiting Federal civilian employment, are complementary. The instructions preclude the use of contracting with firms and institutions outside the Government solely to circumvent personnel ceilings. Agencies that contract out for goods and services under the structured and deliberate process prescribed by OMB Circular A-76 are doing so because it is cost effective and reduces the growth in Government spending.

In light of the trust and responsibilities placed in us by the American people, it is essential that we join together in forming a partnership to ensure OMB Circular A-76 is implemented in an effective and timely manner. Please be assured that my staff and I will work closely with you in this endeavor.

Sincerely,

Edwin L. Harper

Edwin L. Harper
Deputy Director

STATEMENT BY JOHN F. GALUARDI
ACTING COMMISSIONER, PUBLIC BUILDINGS SERVICE
GENERAL SERVICES ADMINISTRATION
BEFORE THE SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
NOVEMBER 4, 1981

MR. CHAIRMAN, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOUR COMMITTEE TODAY TO DISCUSS GOVERNMENT COMPETITION AND TO OUTLINE GSA'S EXPERIENCES IN THIS AREA.

GAO CORRECTLY POINTED OUT THAT IN MANY INSTANCES OUR CLEANING COSTS ARE TOO HIGH. HOW MUCH HIGHER THEY ARE THAN PRIVATE INDUSTRY STANDARDS IS A MATTER OF DEBATE BUT WE DO KNOW THEY ARE TOO HIGH.

MR. GERALD P. CARMEN, THE ADMINISTRATOR OF GSA, HAS PLACED HIGH PRIORITY ON A-76 REVIEW OF ALL GSA SERVICES. HE BELIEVES THAT THE GOVERNMENT SHOULD HAVE ITS SERVICES PERFORMED AT THE LOWEST POSSIBLE COST. HE FEELS THAT THIS CAN BEST BE DONE BY UTILIZING THE COMPETITIVE PROCESS ON A LOW-BID BASIS FROM ALL SEGMENTS OF THE INDUSTRY AND GOVERNMENT.

WE INTEND TO CONFORM WITH THE SOCIOECONOMIC PROGRAMS ESTABLISHED BY LAW IN THE MOST COST-EFFECTIVE MANNER. FOR EXAMPLE, THE GAO REPORT DEALS

WITH HIGHER COSTS RESULTING FROM ENERGY CONSIDERATIONS OF DAY VERSUS NIGHT CLEANING. WE WILL COMPARE ENERGY SAVINGS WITH OTHER COST FACTORS IN MAKING OVERALL COST DETERMINATIONS. THE SOLUTION HERE IS SIMPLE: WE BALANCE CLEANING COSTS AGAINST ENERGY COSTS RESULTING FROM NIGHTTIME OPERATIONS AND FOLLOW WHICHEVER PATH WILL RESULT IN THE LEAST COST TO THE TAXPAYERS.

ANOTHER CONCERN IN THE GAO REPORT WAS THE INCREASED COST OF SPECIFYING A MINIMUM NUMBER OF WORK HOURS IN CONTRACTS. THE SOLUTION HERE IS TO MONITOR CONTRACT PERFORMANCE AS WELL AS THE NUMBER OF HOURS SPENT ON THE JOB.

WE INTEND TO CONSULT WITH THE BUILDING OWNERS AND MANAGERS ASSOCIATION AND OTHERS IN THE PRIVATE SECTOR TO ESTABLISH METHODS AND GUIDELINES THAT WILL PROVIDE EASILY UNDERSTOOD AND ACCURATE COMPARISONS OF EFFICIENCIES AND COSTS .

WE AGREE THAT IMPLEMENTATION OF THE OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-76 IS AN IMPORTANT TOOL IN REDUCING OUR COST OF OPERATION AS WELL AS EMPHASING THE GENERAL FEDERAL POLICY OF OBTAINING SERVICES. UNDER OUR NEW ADMINISTRATOR, WE ARE VIGOROUSLY PURSUING ACCELERATED A-76 IMPLEMENTATION.

IN THIS REGARD, GSA ALREADY HAS INCREASED THE PORTION OF OUR CLEANING WORKLOAD THAT IS PERFORMED BY COMMERCIAL CONTRACTORS FROM 14 PERCENT IN 1973 TO 60 PERCENT IN 1981. IN THE YEAR ENDING SEPTEMBER 30, 1981, OVER 700 OF OUR BUILDINGS, REPRESENTING 71 MILLION SQUARE FEET OF SPACE, WERE CONTRACT CLEANED AT A COST OVER $83 MILLION.

UNDER THE NEW ADMINISTRATION, HOWEVER, WE HAVE INSTRUCTED OUR REGIONAL OFFICES, UNDER THE GUIDELINES OF A-76, TO PROCEED IMMEDIATELY TO CONVERT CLEANING ACTIVITIES WITH AN ANNUAL COST OF $100,000 OR LESS TO CONTRACT, WHERE ECONOMICALLY FEASIBLE. THERE ARE APPROXIMATELY 545 BUILDINGS WITH 12.4 MILLION SQUARE FEET OF SPACE IN THIS CATEGORY.

ALL CLEANING ACTIVITIES OVER $100,000 HAVE BEEN SCHEDULED FOR A COST COMPARISON BEFORE SEPTEMBER 30, 1982. WE ANTICIPATE THAT A SIGNIFICANT PORTION OF THE CURRENT IN-HOUSE CLEANING ACTIVITIES WILL BE CONVERTED TO CONTRACT ON THE BASIS OF LOWER TOTAL COST. THE INCREASED CONTRACTING OUT BY GSA FOR JANITORIAL SERVICES WILL PROVIDE APPROXIMATELY $75 MILLION IN ADDITIONAL REVENUE TO THE BUSINESS COMMUNITY.

AS YOU KNOW, GAO HAS RECOMMENDED THAT WE ALLOW LARGE CONTRACTORS TO BID ON SOME CLEANING CONTRACTS, ESPECIALLY FOR LARGE BUILDINGS. WE ARE EXPLORING THAT POSSIBILITY WITHIN THE FRAMEWORK OF THE LAW. THE NET EFFECT OF ALL THESE ACTIONS SHOULD STILL BE TO INCREASE THE NUMBER OF AWARDS TO SMALL BUSINESSES.

WE AT GSA FEEL THAT VIGOROUS COMPETITION WITHIN THE CONSTRAINTS OF THE LAW IS THE BEST SOLUTION TO COMBATTING RISING COSTS OF CLEANING.

THE BIGGEST AID TO INCREASING SMALL BUSINESS INVOLVEMENT IS TO SIMPLIFY THE RULES AND REGULATIONS SO THAT IT WILL BE EASIER AND MORE PROFITABLE FOR THEM TO DO BUSINESS WITH THE FEDERAL GOVERNMENT.

IN SUMMARY, YOU CAN EXPECT TO SEE SOME MAJOR REFORMS IN GSA'S CLEANING OPERATIONS. BUSINESSMEN WILL HAVE AN INCREASED OPPORTUNITY TO COMPETE FOR GOVERNMENT CONTRACTS. WE INTEND TO SPEND THE TAXPAYERS' MONEY IN A PRUDENT AND BUSINESSLIKE MANNER. WE WELCOME THE CHANCE TO MAKE OUR CLEANING OPERATIONS AS EFFECTIVE AND COMPETITIVELY PRICED AS IN PRIVATE INDUSTRY.

I THANK YOU FOR YOUR INVITATION TO TESTIFY TODAY AND WILL BE GLAD TO ANSWER YOUR QUESTIONS.

STATEMENT OF
THE BUILDING SERVICE CONTRACTORS ASSOCIATION INTERNATIONAL
SUBMITTED TO THE
SUBCOMMITTEE ON ADVOCACY AND THE FUTURE OF SMALL BUSINESS
COMMITTEE ON SMALL BUSINESS
HOLDING HEARINGS ON
GOVERNMENT COMPETITION WITH SMALL BUSINESS
November 4, 1981

STATEMENT OF
THE BUILDING SERVICE CONTRACTORS ASSOCIATION INTERNATIONAL
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November 4, 1981

Mr. Chairman and Committee Members:

My name is James S. Netterstrom, CBSE. I am the Owner and President of Ship Shape Maintenance Company, Inc, a Washington, D.C. building service contracting firm. I am also President-elect of the Building Service Contractors Association International, with headquarters in Vienna, VA. This statement is presented by the Building Service Contractors Association International (BSCA). BSCA International has 1,300 members from thirty-three (33) countries, ninety percent (90%) of which are located in the United States. Members are companies primarily engaged in providing cleaning services on a contract basis.

The building service contracting industry is made up mostly of small businesses. Research by our Association finds the median gross sales volume of member companies is $800,000. It is a labor intensive industry employing primarily part-time labor from among the disadvantaged low-income sector.

BSCA International strongly supports OMB Circular A-76. We read with much regret about the passage of Section 602 of the compromise agreement on the Veterans' Compensation Amendments of 1981. There seems to be no basis of fact to justify granting the Veterans' Administration such a delay in complying with Circular A-76.

Our Association concurs in principle with the Comptroller General's Report to the Congress on GSA's Cleaning Costs are Needlessly Higher Than in the Private Sector. Specifically, BSCA International recommends:

...eliminate minimum staff hour requirements

...institute preaward screening surveys of low-bid contractors

- more -

...require and enforce performance bonds

...conduct on-site cleaning inspections with qualified, trained inspectors

...provide for multi-year contracts

...open contracts to both small and large businesses

...expedite the cost studies required by Circular A-76

...eliminate the requirements for wage determinations or at least revise the methods used to determine the minimum wage specified

...allow flexibility in work scheduling to permit night cleaning.

Mr. Chairman, I will try and answer any questions which may be asked by you and members of the Committee.

Thank you for your attention.

Senator HAYAKAWA. Our next panel consists of Mr. David McCosker, Independent Construction Co., Oakland, Calif.; Mr. David Goldenberg, president, Silver-Coin-O-Matic Division, American Sales, Dayton, Ohio; and Mr. Thomas Crouser, president, Three Printers, Inc., Charleston, W. Va.

I shall ask you gentlemen to summarize your testimony. Your full testimony of course will appear in the record following the panel's presentation, but in the interests of time please give a brief summary.

We will start in the order in which your names appear. Mr. McCosker will be first.

STATEMENT OF DAVID A. McCOSKER, PRESIDENT AND MANAGER, INDEPENDENT CONSTRUCTION CO., OAKLAND, CALIF.

Mr. MCCOSKER. Thank you, Senator Hayakawa.

I am David McCosker. I am president and manager of Independent Construction Co., a grading and paving concern, in Oakland, Calif.

Today I am testifying for the Associated General Contractors of America as chairman of the AGC's contract construction committee.

I want you to know that AGC does support Senate Joint Resolution 93. We also support the resolution's delegation of authority to the Office of Management and Budget to administer that policy.

Force account work today takes on particular significance to us in light of current public works expenditure reductions. At the Federal level, budget reductions which went into effect on October 1 totaled some $38 billion. We can expect further reductions in fiscal year 1982.

As part of these reductions, Federal and federally assisted public works construction will be reduced by a minimum of $18 billion. These reductions make it more important than ever before that public works moneys be spent in the most efficient and economical manner possible.

We believe the reaffirmation of support for reliance on the private sector as contained in Resolution 93 will substantially assist OMB's effort in enforcing the implementing of this policy. The circular's policy is enforced by requiring cost comparisons when inhouse performance is considered for providing goods and services. By requiring such cost comparisons before the selection of the method of providing goods and services, OMB is exercising its fiduciary duty to the taxpaying public.

However, we recommend that their efforts should be expanded to cover the expenditure of all Federal revenues, not just those used in direct Federal procurement.

OMB has had some difficulty in administering circular A-76. For example, after receiving the original A-76 circular issued in 1976, the Tennessee Valley Authority defined its entire construction program as an existing Government activity and waived the requirement for further review. As a result, TVA has exempted itself from the requirement to cost justify its force account construction.

We believe, as apparently does the Office of Management and Budget, that in the public interest as well as in the interest of fostering the Government's policy of utilization of private enterprise, TVA should meet the requirements of OMB circular A-76. The additional support for this policy expressed in Senate Joint Resolution 93 for the Office of Management and Budget should facilitate the compliance of agencies like TVA.

Congressional affirmation of the policy of relying on the private sector for needed goods and services should also assist the Office of Management and Budget in requiring agencies to use the cost accounting principles on a more frequent basis.

The Army Corps of Engineers has not performed any cost-comparison studies pursuant to circular A-76 during the last fiscal year. Yet that agency conducts dredging and revetment work with its own construction forces in the lower Mississippi Valley. Over $95 million of dredging and fully half of the $63 million of revetment projects was performed by in-house forces. The last cost-comparison review was conducted in 1977 and 1978. We believe more frequent cost comparisons will result in more conversions and savings to the taxpaying public

Senate Joint Resolution 93 can serve as a vehicle for further economies by endorsing expansion of their cost-comparison techniques. OMB is developing a substantial expertise in administering cost-comparison programs. They have a new educational program for Federal managers which was instituted in August of this year by OMB. The course guide, 60 hours of video program and a complementing cassette program, provides OMB with the essential tools to provide instruction for Government managers.

Unfortunately, OMB's exertise will not be used in federally assisted programs where a significant portion of Federal construction funds are spent. The taxpaying public has the right to have its funds spent in the most efficient and economical manner possible on all public works projects. The distinction between Federal and federally assisted construction programs should not be a reason to deny the security of comprehensive cost comparisons in protecting public expenditures from inefficient use.

For example, the Federal Highway Administration publication "Monthly Highway Construction Contracts Awarded by State and Federal Agencies and Toll Authorities" reveals the following disturbing figures: $120.9 million in Federal aid and direct Federal construction was done by force account in calendar year 1978. Of that total, $102.2 million was Federal funds.

In 1979, out of $125.8 million, $107.5 million were Federal funds. In the first half of 1980, out of $48.1 million, $41 million were Federal funds.

In fact, agency regulations authorize the use of force account construction upon a finding, without cost comparisons involved, that it is in the public interest. The public interest definition includes situations where there is a lack of bids or the bids received are unreasonable.

We find it difficult to believe that almost $300 million in Federal highway construction work over a 2½-year period met this definition. We believe taxpayers would prefer being able to review cost-comparison studies to assure that these moneys were spent in the most economic manner.

In addition to assuring the prudent expenditure of Federal funds by requiring cost comparisons, expansion of OMB circular A-76 to include federally assisted construction would also provide many State and local governments their first experience in using comprehensive cost comparisons.

Currently there are no standard cost-comparison principles in public sector accounting. In California, we have had that problem with the city of Los Angeles which has misplaced 88,000 tons of asphalt. We had problems with the city of Concord. In depositions taken from them, three public officials gave different amounts for the cost of a reconstruction project.

Skills developed in administering cost comparisons in federally assisted programs would assist States in the transfer of those principles to strictly local projects, thus achieving efficiencies similar to those available in direct Federal procurement.

Contracting out also provides a variety of other benefits to the public in the form of risk shifting which cannot be obtained under in-house performance. Rather than go through all of those, they are submitted to you, Senator.

I would just say, to take these risks away from the taxpayers and put them on a private contractor, who through his payment and performance bond guarantees the job will be finished according to the terms of the contract, is worth a great deal in dollars. None of this protection of the public's interest exists when the work is performed by a public agency with public equipment and personnel. All of the risks are on the taxpayer.

Another benefit of the contract method, often overlooked by the public officials, is the recycling of tax dollars. An Ohio study concluded that taxpayers receive a net return of anywhere from 23.2 to 24.5 percent of the contract cost when contract construction is chosen over force account construction.

Although cost is the most important factor in deciding whether to contract out or use in-house forces, public agencies should also be aware of the social implications of doing their own construction. When force account activities start, the public agencies usually begin with smaller projects. As their forces grow, the size of the projects grow.

It is this tendency to take over small- and medium-size projects which most affects the construction industry. We are an industry made up of hundreds of thousands of small firms. Performance of small- and medium-size projects by public agencies forecloses important growth opportunities for emerging small firms, including many minority-owned firms. Because of low overhead costs, these small firms are very cost competitive. Construction by force account of these small- and medium-size projects denies small firms their rightful place in the market.

It is well known that small business generates the majority of new jobs in the country as well. These firms offer employment experience in skilled trades which equip an individual with experience that can provide an excellent living. In construction, some of these skilled workers eventually become contractors themselves.

The effect of force account construction therefore is to foreclose growth opportunities for existing businesses, deny new firms the opportunity for expansion, deny entry employment for many individuals, and to prevent those individuals from becoming small businessmen. The irony of having a public agency producing this result is readily apparent.

We hope Members of the House and Senate will take an important step to correct many of the problems with force account construction by voting for Senate Joint Resolution 93.

Thank you.

Senator **HAYAKAWA**. Thank you, Mr. McCosker.

We shall next hear from Mr. David Goldenberg.

STATEMENT OF DAVID L. GOLDENBERG, PRESIDENT, SILVER COIN-O-MATIC DIVISION, AMERICAN SALES, INC., DAYTON, OHIO

Mr. **GOLDENBERG**. I am David Goldenberg, president of Silver-Coin-O-Matic in Dayton, Ohio. I appreciate the opportunity to be here in favor of Senate Joint Resolution 93.

During 1979 and 1980 I served on the SBA task group on Government competition. My experiences as a member of that group were some of the most dramatic of my adult life. The more testimony we heard, the more I realized the pervasiveness of Government competition at all levels, but especially competition with small business.

My reaction was at first one of anger, but then fear, fear that the free enterprise system to which we all credit the strength of our Nation was in great jeopardy not from revolution, not from erosion within the system, but from Government, the same Government whose purpose it is to protect that system.

I know you have heard other testimony on the activities of the task group so I will not repeat the almost overwhelming number of cases which we examined. However, since the completion of our work, I have continued to find examples of Government competition with small business.

I am vice chairman of the Independent Business Council of the Dayton Area Chamber of Commerce, which is the small business arm, and, since I was asked to testify before this committee, I have been deluged by calls from many diverse businesses giving vivid illustration to the problem: A testing laboratory, a collection agency, a travel agency, and even a trophy shop.

The tremendous scope of this problem is of great concern to me as a citizen, and it is also of great concern to me as a small businessman.

Let me first describe may business and then why the passage of the joint resolution is so important to my business and many of the small firms like mine in our industry. I will also propose one extension to the policy of the resolution.

For the past 20 years my company has provided laundry equipment in residential housing of all types in our market area. We purchase and install washers and dryers in common laundry facilities, collect the coins paid into the machines, and service the machines. We provide these machines in apartment buildings, condominiums, several colleges and universities, senior citizen and nursing homes, and Rickenbacker Air Force Base in Columbus, Ohio.

In many cases, the machines are leased with service, or, in exchange for the right to operate the laundry room, we provide the owner of the building or facility with a substantial proportion of the gross income we collect. We have a central office in Dayton, warehousing facilities, a service office in Columbus, 11 service, collection, and sales vehicles, and we employ 15 persons.

The multifamily housing laundry industry that I am a part of has several hundred small firms like mine, operating mostly in population centers but also serving multifamily housing, usually in communities within a roughly 100-mile radius of their operations.

Our industry was essentially created after World War II. We received no Federal assistance. The industry has managed to grow from a zero point to one which grosses and, in the main, pays taxes on between $600 and $700 million of income per year. Our growth has occurred in the face of increasing problems of inflation, urban crime, and vandalism, the difficulty of finding capable service and repair employees, and the significant and rising financing costs.

The future of our business may, however, in the long run be contingent on changing the Government's policy in using Federal housing funds. I believe Senate Joint Resolution 93 holds a promise for doing this.

As you are no doubt aware, where Federal agencies construct and operate housing projects themselves, they are prohibited by OBM A-76 from purchasing laundry equipment without first doing a cost analysis. This order was developed after many years of study and preparation. In almost every instance, such a cost analysis concludes that the private sector can supply the necessary laundry service at lower costs.

The reach of OMB A-76, however, is now of limited character. With the exception of military housing, governmentally funded multifamily residence housing is largely in the hands of State and local housing authorities and such quasi-governmental entities as dormitory authorities.

The Department of Housing and Urban Development presently permits State and municipal housing authorities to use Federal grants to purchase laundry room equipment, washers and dryers, in public housing projects they operate. Not only does this procedure use Federal moneys to compete directly and unfairly with the private businesses of industry members, but the practice is almost invariably much more costly than contracting with members of my industry to supply and service that equipment.

Another practice detrimental to companies such as ours is the Department's policy of allowing some Federal housing facilities to be planned, plumbed, and wired so that each individual apartment in the project has its own washer and dryer in preference to any common laundry room facility. Apart from the dollar costs, machines in individual apartments are used three to four times as much as fee charging machines in a common laundry room with substantial attendant consumption of scarce energy and water resources.

Mr. Chairman, I and the other small businessmen of our industry seek no Federal subsidy, no handout, and no private sector monopoly on laundry room business. Our simple request is only that no Federal funds should be used to subsidize the purchase of multifamily residence laundry equipment or individual apartment facilities, either directly or indirectly, unless there is a demonstrated cost savings to the Government.

I strongly support the general concept of your resolution that small private businesses should be free from unfair competition financed by their own tax dollars. This should particularly be so in those circumstances where that competition also increases the total cost of the Federal housing programs to the Nation while unnecessarily reducing the number of genuinely needy persons who can be served within the limits of a set Federal housing appropriation.

Mr. Chairman, when the task group on which I served made its recommendation, we recognized that OMB A-76 needed a resolution such as Joint Resolution 93 in order to be effective. We also recognized the tremendous problem at State and local levels. For this reason, I ask that the salutary Senate Joint Resolution 93 be specifically extended to include State and municipal housing authority and other entities receiving Federal housing funds.

Thank you again, Mr. Chairman.

Senator HAYAKAWA. Thank you very much. That is a most interesting suggestion you make at the end of your statement.

Mr. Thomas Crouser of Charleston, W. Va.?

STATEMENT OF THOMAS CROUSER, PRESIDENT, THREE PRINTERS, INC., CHARLESTON, W. VA., ACCOMPANIED BY JOHN F. GRANT, HARRIS, BEACH, WILCOX, RUBIN & LEVEY, WASHINGTON, D.C.

Mr. CROUSER. Thank you very much, Mr. Chairman.

As you say, I am Tom Crouser, president of Three Printers in Charleston. It is a small printing company. I am appearing here today on behalf of the National Association of Quick Printers upon whose board I have served. With me is Mr. John Grant of our Washington counsel. He is a member of the firm of Harris, Beach, Wilcox, Rubin & Levey.

The National Association of Quick Printers represents over 3,000 member firms across this country; 98 of all printing companies are companies with less than 20 employees. We are a small business.

In an attempt to summarize, we have heard a lot about OMB A-76. Significantly, printing, as such, does not come under the purveiw of this memorandum. Printing has been reserved by the Congress under title 44 and under the Joint Committee on Printing.

However, recently the General Accounting Office, in response to a request by the chairman of the Joint Committee on Printing, Senator Mathias, conducted a study entitled "Agency Printing Plants—Choosing the Least Costly Option." The report identified approximately 234 million dollars worth of printing and duplicating which the GAO thought could be more economically procured from commercial firms, yet was being produced by agency printing plants at exceedingly high cost to the taxpayer. This is where we of NAQP feel we have a problem.

The report also concluded that the Government should explore the possibilities of expanding the in-house copying and duplicating services. These are items which our members produce and where we feel the Government is conducting some unfair competition.

We believe we have developed a proposal which addresses both of the GAO concerns while accomplishing a number of other goals. Let me explain that at the present time whenever the Government has a need from shortrun printing or duplication, it fulfills the need by having the material produced on a fast photocopying machine or a small offset printing press. Virtually every Federal installation in every city of our Nation has such equipment whether or not there is a demonstrated need for it and regardless of the availability of such services in the immediate commercial area.

Large, expensive photocopying machines and extra presses are maintained over present requirements basically so that whenever the Government has a rush requirement, which we recognize is possible, the equipment is available to produce that particular job.

We propose that, whenever the Government has a need for printing, copying, or duplicating of units that do not exceed 5,000 copies or 25,000 total in the aggregate, which is to be produced within 72 hours, it survey by telephone small businesses which have indicated a willingness to participate.

Under the program, a local agency would be required to solicit prices for some specifc goods. The Government would have to determine how many bids were necessary and under what circumstances in order to preserve the competitive bidding process.

When each bidder was told the requirements for the bid, the price would be solicited by the Government procurement officer. In turn, each firm would be required to file immediately, probably by something like a post card, a statement indicating the job order number and the price bid. If the firm failed, there could be an elimination of participation for a specific time.

In this manner, the Government would have the evidence that it requires that competitive bids were solicited. When we have solicited those bids, the winning bidder would be informed by telephone of the award and asked to produce the material in the required time.

After the work was performed and delivered, the winning contractor would be given a voucher form which he could present to the officer in charge of the petty cash fund for immediate payment. At the present time, procurement regulations state that petty cash is available for a number of items which generally are considered to encompass those needs which do not lend themselves to long-range Government planning. The figure available today is $150. We propose that the figure be increased possibly to $350.

In addition to the present allowable actions, we ask that copying and duplication services that are returnable within 72 hours be added to those services enumerated for which the petty cash funds may be spent. We ask also that the funds be available on a revolving basis. Internally, those funds expended for this purpose would be charged against the agency's line item appropriation for printing and publication services.

Were this program to be initiated, the Governemnt would benefit because it would not have to make the investment in increased equipment and facilities in order to provide the growing need for copy and duplicating services as cited in the GAO report. In addition, agencies would be able to increase their record of small business participation in contracting procedures.

No new Federal expenditures are necessary inasmuch as present capability within our industry is available to serve all of the Federal need. Agencies which now produce like material at a lower cost than what they could procure immediately outside would not be forced to go outside. Other agencies with overload situations and those which because of low level in-house production pay a high rate for the production of those materials could take advantage of the availability of the commercial market under these circumstances.

I appreciate the opportunity to present our views. We are willing to answer any questions you may have.

Senator HAYAKAWA. Thank you very much, Mr. Crouser.

Mr. McCosker, would you tell all of us about the TVA. That was really a kind of surprise to me. I had not thought about TVA in this connection. Do they do everything in-house?

Mr. McCOSKER. They do just about everything in-house. They have subcontracted out some of their work, but the majority of the work is held for in-house.

Senator HAYAKAWA. They are under no Government directives to contract out?

Mr. COSKER. As I stated there, they ignore circular A-76. They say that it does not pertain to their situation.

Senator HAYAKAWA. That is very harmful to small business in that region?

Mr. McCOSKER. No question about it, sir. It is not only that, but from a competitive standpoint, the contractor's quality of work can be just as good, if not better, and, for one thing, it is a guarantee. Of course, in private industry we have a profit incentive, which is something that does not exist on the other side of the fence. We either get with it and get it done or we are not in business very long.

Senator HAYAKAWA. Do you believe that private construction contractors can perform comparable work now being done by TVA or the Army Corps of Engineers?

Mr. McCOSKER. Yes, sir, I believe we can perform that work.

Senator HAYAKAWA. The Army Corps of Engineers does most of it?

Mr. McCOSKER. The Army Corps of Engineers does about half of their work. They have put half out to bid.

Senator HAYAKAWA. They could contract out more than they do?

Mr. McCOSKER. We believe they could. If nothing else, they should come forth with some cost analysis to see whether or not it is even prudent for them to be doing the work.

Senator HAYAKAWA. These are very, very interesting facts.

Mr. Goldenberg, I found your testimony most interesting, too, about providing laundry machines to multiunit buildings and how the Government itself, particularly at the local level, has taken over the function of providing this service.

The wonderful thing about this committee which I have enjoyed so much is I learn so much about other people's business. So much of it is fascinating. So many of your problems are things that I have never dreamed about or thought about before.

Mr. Crouser, I think your testimony provides the most difficult problem. In every Senate office, and I am sure in every office in the House of Representatives, there is a Xerox machine, is there not?

Mr. CROUSER. Yes, sir.

Senator HAYAKAWA. It is there because we want 12 copies of this document or that document in 5 or 10 minutes. That is not a service you can provide, is it?

Mr. CROUSER. Generally no, sir. What we are speaking of is shortrun printing and duplicating.

Senator HAYAKAWA. Within 72 hours?

Mr. CROUSER. Within 72 hours. It is not the convenience copying function which we recognize is a very valid function.

Senator HAYAKAWA. Yes.

Mr. CROUSER. However, how many times do we put a thousand of one or a little bit longer things on some of these machines.

Senator HAYAKAWA. I do know there are times when we want 500 to 1,000 copies of something. These things occur constantly.

What about all the reprints of Senators' and Congressmen's speeches when we get out 5,000, 10,000, and sometimes more copies for the larger States? That is something we do in-house.

Mr. CROUSER. Yes, sir. Those things basically are pretty well regulated in the sense that the Government Printing Office cannot handle those types of things. What happens so many times where I am in Charleston, W. Va., is the Government agencies have no local availability to procure without going through a lot of redtape. Therefore, what they do is add to their equipment and facilities, which basically defeats both of our purposes. That is, the cost of Government goes up and the work then disappears from the commercial sector.

Senator HAYAKAWA. Printing is not included in OMB A-76, is it?

Mr. GRANT. Sir, if I may answer that, my name is John Grant. I am counsel for the association.

Government printing is under the jurisdiction of title 44 of the United States Code. Circular A-76 applies to the executive branch. As to those actions under title 5 and title 41, the procurement statutes, the Congress has specifically reserved to itself control over Federal printing through the Joint Committee on Printing. During the last revision of A-76 in 1978 or 1979, it was going to be included, but it was specifically taken out in the final draft. It is completely under the control of the Congress.

Senator HAYAKAWA. From the point of view of people in your situation, you would like printing included in A-76?

Mr. GRANT. It would very definitely be helpful. The proposal we have made could accomplish the same purpose and could be done very simply by a directive from the Joint Committee on Printing and by a very small change in the Federal Procurement Regulations affecting the petty cash funds.

Senator HAYAKAWA. Even if that change were made, an enormous amount of the printing done by Government would have to continue to be done by the Government, right?

Mr. GRANT. Very definitely the Congressional Record, the Federal Register, security items, money, quasi-money would be appropriate to be done by the Federal Government. It is the other things that do not have to be done by the Federal Government that we are talking about.

Senator HAYAKAWA. Thank you very much.

[The prepared statements of Mr. McCosker, Mr. Goldenberg, and Mr. Crouser follow:]

Testimony of

David A. McCosker

For

The Associated General Contractors of America

Presented to the

Senate Select Committee on Small Business

Subcommittee on the Advocacy and Future of Small Business

United States Senate

November 4, 1981

On the Topic of

Government Competition with Small Business

AGC is:

- More than 30,000 firms including 8,400 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;
- 113 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities;
- Approximately 50% of the contract construction by American firms in more than 100 countries abroad.

GOOD MORNING, MY NAME IS DAVID MCCOSKER. I AM THE PRESIDENT AND MANAGER OF INDEPENDENT CONSTRUCTION COMPANY IN OAKLAND, CALIFORNIA. TODAY I AM TESTIFYING FOR THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA AS CHAIRMAN OF AGC'S CONTRACT CONSTRUCTION COMMITTEE.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA (AGC) REPRESENTS MORE THAN 30,000 FIRMS INCLUDING 8,400 OF AMERICA'S LEADING GENERAL CONTRACTING COMPANIES WHICH ARE RESPONSIBLE FOR THE EMPLOYMENT OF MORE THAN 3,500,000 EMPLOYEES. THESE MEMBER CONTRACTORS PERFORM MORE THAN 80% OF AMERICA'S CONTRACT CONSTRUCTION OF COMMERCIAL BUILDINGS, HIGHWAYS, INDUSTRIAL AND MUNICIPAL-UTILITY FACILITIES.

AGC SUPPORTS SENATE JOINT RESOLUTION 93 WHICH REAFFIRMS THE BASIC POLICY OF THE GOVERNMENT THAT IT SHOULD NOT COMPETE WITH THE COMPETITIVE FREE ENTERPRISE SYSTEM AND SHOULD RELY ON THAT SYSTEM FOR THE GOODS AND SERVICES IT REQUIRES. WE ALSO SUPPORT THE RESOLUTION'S DELEGATION OF AUTHORITY TO THE OFFICE OF MANAGEMENT AND BUDGET TO ADMINISTER THE POLICY. THE EXPRESSION OF SUPPORT FOR RELIANCE ON THE COMPETITIVE FREE ENTERPRISE SYSTEM BY BOTH HOUSES OF CONGRESS SHOULD SUBSTANTIALLY BOLSTER OMB'S EFFORT TO IMPLEMENT ITS STANDING POLICY OF RELIANCE ON THE PRIVATE SECTOR AS EXPRESSED IN OMB CIRCULAR A-76.

THE ISSUE OF CONSTRUCTION BY GOVERNMENT FORCES -- IN-HOUSE CONSTRUCTION -- OR AS IT IS MORE COMMONLY REFERRED TO "FORCE ACCOUNT CONSTRUCTION" VERSUS THE USE OF PRIVATE CONTRACTORS -- CONSTRUCTION BY CONTRACT -- IS NOT NEW. A TRADE PUBLICATION

CONTAINED AN ARTICLE DISCUSSING THE PROS AND CONS OF THE TWO METHODS IN CONSTRUCTING SEWERS IN NEW ORLEANS IN THE AUGUST 13, 1914, ISSUE OF THE MAGAZINE. THE ISSUE TAKES ON PARTICULAR SIGNIFICANCE IN LIGHT OF CURRENT PUBLIC WORKS EXPENDITURE REDUCTIONS. AT THE FEDERAL LEVEL BUDGET REDUCTIONS THAT WENT INTO EFFECT ON OCTOBER 1ST TOTALED $38 BILLION AND WE CAN EXPECT FURTHER REDUCTIONS IN FISCAL YEAR 1982.

AS PART OF THESE REDUCTIONS, FEDERAL AND FEDERALLY-ASSISTED PUBLIC WORKS CONSTRUCTION WILL BE REDUCED BY A MINIMUM OF $18 BILLION. THESE REDUCTIONS MAKE IT MORE IMPORTANT THAN EVER BEFORE THAT PUBLIC WORKS MONIES BE SPENT IN THE MOST EFFICIENT AND ECONOMICAL MANNER POSSIBLE. WITH FEWER FUNDS AVAILABLE FOR MUCH NEEDED PUBLIC WORKS PROJECTS, THE TAXPAYING PUBLIC HAS THE RIGHT TO DEMAND THAT IT GETS THE MOST FOR ITS MONEY.

WE BELIEVE THE REAFFIRMATION OF SUPPORT FOR RELIANCE ON THE PRIVATE SECTOR, AS CONTAINED IN RESOLUTION 93, WILL SUBSTANTIALLY ASSIST OMB'S EFFORT IN ENFORCING THE IMPLEMENTATION OF THIS POLICY. THE CIRCULAR'S POLICY IS ENFORCED BY REQUIRING COST COMPARISONS WHEN IN-HOUSE PERFORMANCE IS CONSIDERED FOR PROVIDING GOODS AND SERVICES. BY REQUIRING SUCH COST COMPARISONS BEFORE THE SELECTION OF THE METHOD OF PROVIDING GOODS AND SERVICES, OMB IS EXERCISING ITS FIDUCIARY DUTY TO THE TAXPAYING PUBLIC. WE RECOMMEND, HOWEVER, THAT OMB'S EFFORTS SHOULD BE EXPANDED TO COVER THE EXPENDITURE OF ALL FEDERAL REVENUES, NOT JUST THOSE USED IN DIRECT FEDERAL PROCUREMENT.

OMB HAS HAD SOME DIFFICULTY IN ADMINISTERING CIRCULAR A-76. FOR EXAMPLE, AFTER RECEIVING THE ORIGINAL A-76 CIRCULAR, ISSUED IN 1976, THE TENNESSEE VALLEY AUTHORITY DEFINED ITS ENTIRE CONSTRUCTION PROGRAM AS AN "EXISTING GOVERNMENT ACTIVITY," AND WAIVED THE REQUIREMENT FOR FURTHER REVIEW. AS A RESULT, TVA HAS

EXEMPTED ITSELF FROM THE REQUIREMENT TO COST JUSTIFY ITS FORCE ACCOUNT CONSTRUCTION.

IN 1971, A TVA TASK FORCE, MADE UP OF THREE CONSULTANTS AND TWO FORMER TVA OFFICIALS, STUDIED VARIOUS ASPECTS OF TVA'S OFFICE OF ENGINEERING DESIGN AND CONSTRUCTION OPERATIONS. ONE AREA REVIEWED WAS FORCE ACCOUNT VERSUS CONTRACT CONSTRUCTION. IN ITS REPORT, THE TASK FORCE CONCLUDED THAT

-- TVA HAS NOT DEVELOPED DETAILED COMPARISONS TO SUPPORT ITS CLAIM THAT CONSTRUCTION BY FORCE ACCOUNT WAS COMPETITIVE WITH PRIVATE INDUSTRY; AND,

-- BECAUSE OF THE LIMITED COST DATA FOR COMPARISON PURPOSES, NO JUDGEMENT COULD BE MADE ON THE MERITS OF FORCE ACCOUNT VERSUS CONTRACT CONSTRUCTION.

IN 1979, A STUDY OF TVA'S IN-HOUSE METHOD OF DESIGN AND CONSTRUCTION COULD NOT CONCLUDE THAT TVA WAS DOING ENOUGH PRIVATE CONTRACTING. TVA ONCE AGAIN ON MARCH 6, 1981, IN A RESPONSE TO AGC (APPENDED TO THIS STATEMENT) REAFFIRMED ITS POSITION THAT TVA IS NOT SUBJECT TO GOVERNMENT WIDE PROCUREMENT SYSTEMS.

WE BELIEVE, AS APPARENTLY DOES THE OFFICE OF MANAGEMENT AND BUDGET, THAT IN THE PUBLIC INTEREST AS WELL AS IN THE INTEREST OF FOSTERING THE GOVERNMENT'S POLICY OF UTILIZATION OF PRIVATE ENTERPRISE, TVA SHOULD MEET THE REQUIREMENTS OF OMB CIRCULAR A-76. THE ADDITIONAL SUPPORT FOR THIS POLICY EXPRESSED IN SENATE JOINT RESOLUTION 93 FOR THE OFFICE OF MANAGEMENT AND BUDGET SHOULD FACILITATE THE COMPLIANCE OF AGENCIES LIKE TVA.

CONGRESSIONAL AFFIRMATION OF THE POLICY OF RELYING ON THE PRIVATE SECTOR FOR NEEDED GOODS AND SERVICES SHOULD ALSO ASSIST

THE OFFICE OF MANAGEMENT AND BUDGET IN REQUIRING AGENCIES TO USE THE COST ACCOUNTING PRINCIPLES ON A MORE FREQUENT BASIS. THE ARMY CORPS OF ENGINEERS HAS NOT PERFORMED ANY COST COMPARISON STUDIES PURSUANT TO CIRCULAR A-76 DURING THE LAST FISCAL YEAR - YET THAT AGENCY CONDUCTS DREDGING AND REVETMENT WORK (LAYING A CEMENT MATTRESS ON A RIVER BED) WITH ITS OWN CONSTRUCTION FORCES IN THE LOWER MISSISSIPPI VALLEY. OVER $95 MILLION OF DREDGING AND FULLY HALF OF THE $63 MILLION OF REVETMENT PROJECTS WAS PERFORMED BY IN-HOUSE FORCES. THE LAST COST COMPARISONS REVIEW WAS CONDUCTED DURING 1977 AND 1978 WHEN A SUBSTANTIAL PORTION OF TOWING OF MATERIALS AND EQUIPMENT WAS CONVERTED TO CONTRACTING OUT, ACCORDING TO THE CORPS. WE BELIEVE MORE FREQUENT COST COMPARISON WILL RESULT IN MORE CONVERSIONS AND SAVINGS TO THE TAX PAYING PUBLIC.

IN ADDITION TO EXPRESSING SUPPORT FOR THE POLICY OF RELIANCE ON THE PRIVATE SECTOR FOR GOODS AND SERVICES AND THE USE OF COST COMPARISONS AS ADMINISTERED BY THE OFFICE OF MANAGEMENT AND BUDGET, S. J. RESOLUTION 93 CAN SERVE AS A VEHICLE FOR FURTHER ECONOMIES BY ENDORSING EXPANSION OF OMB'S COST COMPARISON TECHNIQUES. OMB IS DEVELOPING A SUBSTANTIAL EXPERTISE IN ADMINISTERING COST COMPARISON PROGRAMS. A NEW EDUCATION PROGRAM FOR FEDERAL MANAGERS WAS INSTITUTED IN AUGUST OF THIS YEAR BY OMB. THE COURSE GUIDE, 60 HOURS VIDEO PROGRAM, AND COMPLEMENTING CASSETTE PROGRAMS PROVIDE OMB WITH THE ESSENTIAL TOOLS TO PROVIDE INSTRUCTION FOR GOVERNMENT MANAGERS. UNFORTUNATELY, OMB'S EXPERTISE WILL NOT BE USED IN FEDERALLY-ASSISTED PROGRAMS WHERE A SIGNIFICANT PORTION OF FEDERAL CONSTRUCTION FUNDS ARE SPENT. THE TAXPAYING PUBLIC HAS THE RIGHT TO HAVE ITS FUNDS SPENT IN THE MOST EFFICIENT AND ECONOMICAL MANNER POSSIBLE ON ALL PUBLIC WORKS PROJECTS. THE DISTINCTION BETWEEN FEDERAL AND FEDERALLY-ASSISTED

CONSTRUCTED PROGRAMS SHOULD NOT BE A REASON TO DENY THE SECURITY OF COMPREHENSIVE COST COMPARISONS IN PROTECTING PUBLIC EXPENDITURES FROM INEFFICIENT USE.

FOR EXAMPLE, THE FEDERAL HIGHWAY ADMINISTRATION PUBLICATION "MONTHLY HIGHWAY CONSTRUCTION CONTRACTS AWARDED BY STATE AND FEDERAL AGENCIES AND TOLL AUTHORITIES" REVEALS THE FOLLOWING DISTURBING FIGURES:

> $120.9 MILLION IN FEDERAL-AID AND DIRECT FEDERAL CONSTRUCTION WAS DONE BY FORCE ACCOUNT IN CALENDAR YEAR 1978. OF THAT TOTAL, $102.2 MILLION WAS FEDERAL FUNDS.
>
> $125.8 MILLION IN FEDERAL-AID AND DIRECT FEDERAL CONSTRUCTION WAS DONE BY FORCE ACCOUNT IN CALENDAR YEAR 1979. OF THAT TOTAL $107.5 MILLION WAS FEDERAL FUNDS.
>
> $48.1 MILLION IN FEDERAL-AID AND DIRECT FEDERAL CONSTRUCTION WAS DONE BY FORCE ACCOUNT THROUGH THE FIRST SIX MONTHS OF 1980. OF THAT TOTAL $41 MILLION WAS FEDERAL FUNDS.

IN FACT, AGENCY REGULATIONS AUTHORIZE THE USE OF FORCE ACCOUNT CONSTRUCTION UPON A FINDING (WITHOUT COST COMPARISONS) THAT IT IS IN THE PUBLIC INTEREST. THE PUBLIC INTEREST DEFINITION INCLUDES SITUATIONS WHERE THERE IS A LACK OF BIDS OR THE BIDS RECEIVED ARE UNREASONABLE. WE FIND IT DIFFICULT TO BELIEVE THAT ALMOST $300 MILLION IN FEDERAL HIGHWAY CONSTRUCTION WORK OVER A TWO AND A HALF YEAR PERIOD MET THIS DEFINITION. WE BELIEVE TAXPAYERS WOULD PREFER BEING ABLE TO REVIEW COST COMPARISON STUDIES TO

ASSURE THAT THESE MONIES WERE SPENT IN THE MOST ECONOMIC MANNER.

IN ADDITION TO ASSURING THE PRUDENT EXPENDITURE OF FEDERAL FUNDS BY REQUIRING COST COMPARISONS, EXPANSION OF OMB CIRCULAR A-76 TO INCLUDE FEDERALLY-ASSISTED CONSTRUCTION WOULD ALSO PROVIDE MANY STATE AND LOCAL GOVERNMENTS THEIR FIRST EXPERIENCE IN USING COMPREHENSIVE COST COMPARISONS. CURRENTLY THERE ARE NO STANDARD COST COMPARISON PRINCIPLES IN PUBLIC SECTOR ACCOUNTING. WITH REDUCED BUDGET OUTLAYS, PUBLIC OFFICIALS HAVE AN INCREASED RESPONSIBILITY TO ASSURE THAT THE REMAINING FUNDS ARE SPENT IN THE MOST EFFICIENT AND ECONOMICAL MANNER. SKILLS DEVELOPED IN ADMINISTERING COST COMPARISONS IN FEDERALLY-ASSISTED PROGRAMS WOULD ASSIST STATES IN THE TRANSFER OF THOSE PRINCIPLES TO STRICTLY LOCAL PROJECTS, THUS ACHIEVING EFFICIENCIES SIMILAR TO THOSE AVAILABLE IN DIRECT FEDERAL PROCUREMENT.

IN ADDITION TO PROVIDING THE MOST EFFICIENT AND ECONOMICAL MEANS OF PRODUCING PUBLIC WORKS CONSTRUCTION, CONTRACTING OUT PROVIDES A VARIETY OF OTHER BENEFITS TO THE PUBLIC IN THE FORM OF RISK SHIFTING, WHICH CANNOT BE OBTAINED UNDER IN-HOUSE PERFORMANCE. LET ME BRIEFLY REVIEW HOW SOME OF THESE RISKS ARE ALLOCATED WHEN CONSTRUCTION IS DONE BY CONTRACT:

-- THE PUBLIC ONLY PAYS FOR WHAT IT RECEIVES; WORK ACTUALLY PERFORMED IS THE BASIS OF PAYMENT.

-- THE PRICE IS FIXED AND GUARANTEED BY THE CONTRACT, AND THE PUBLIC HAS NO RISK OF COST INCREASES. ALL OF THE VARIABLES OF THE MARKET PLACE, SUCH AS INCREASES IN MATERIAL PRICES, WAGES AND SHORTAGES ARE BORNE BY THE PRIVATE CONTRACTOR.

-- TIMELY COMPLETION IS ASSURED BY A LIQUIDATED DAMAGE PROVISION.

-- FAITHFUL PERFORMANCE IS BACKED BY PERFORMANCE AND PAYMENT BONDS.

-- RISK OF DAMAGE DURING CONSTRUCTION IS BORNE BY THE CONTRACTOR, NOT THE PUBLIC.

-- THE CONTRACTOR MUST "DEFEND AND HOLD HARMLESS" THE PUBLIC AGAINST CLAIMS AND MUST PROVIDE THE PUBLIC WITH INSURANCE COVERAGE.

-- QUALITY INSPECTION IS AT "ARM'S LENGTH" BY INDEPENDENT INSPECTORS.

-- THE FINAL WORK IS WARRANTED AND DEFECTS MUST BE CORRECTED AT NO EXPENSE TO THE PUBLIC.

TO TAKE THESE RISKS AWAY FROM THE TAXPAYERS AND PUT THEM ON A PRIVATE CONTRACTOR WHO, THROUGH HIS PAYMENT AND PERFORMANCE BOND, GUARANTEES THE JOB WILL BE FINISHED ACCORDING TO THE TERMS OF THE CONTRACT, IS WORTH A GREAT DEAL IN DOLLARS. NONE OF THIS PROTECTION OF THE PUBLIC'S INTEREST EXISTS WHEN WORK IS PERFORMED BY A PUBLIC AGENCY WITH PUBLIC EQUIPMENT AND PERSONNEL -- ALL OF THE RISKS ARE ON THE TAXPAYER.

ANOTHER BENEFIT OF THE CONTRACT METHOD, OFTEN OVERLOOKED BY PUBLIC OFFICIALS, IS A RETURN OF PART OF THE CONTRACT PRICE TO THE PUBLIC TREASURY IN THE FORM OF TAXES. AN OHIO STUDY CONCLUDED THAT TAXPAYERS RECEIVE A NET RETURN OF 23.2 - 24.5 PERCENT OF THE CONTRACT COST WHEN CONTRACT CONSTRUCTION IS CHOSEN OVER FORCE ACCOUNT CONSTRUCTION. THIS INDIRECT COST REDUCTION TO THE PUBLIC IS NOT FACTORED INTO COST COMPARISON COMPUTATIONS AND RESULTS FROM A VARIETY OF USE, EXCISE, EMPLOYMENT AND INCOME TAXES.

ALTHOUGH COST IS THE MOST IMPORTANT FACTOR IN DECIDING WHETHER TO CONTRACT-OUT OR USE IN-HOUSE FORCES, PUBLIC AGENCIES SHOULD ALSO BE AWARE OF THE SOCIAL IMPLICATIONS OF DOING THEIR OWN CONSTRUCTION. WHEN FORCE ACCOUNT ACTIVITIES START THE PUBLIC AGENCIES USUALLY BEGIN WITH SMALLER JOBS. AS THEIR FORCES GROW, THE SIZE OF THE PROJECTS GROW. IT IS THIS TENDENCY TO TAKE OVER SMALL AND MEDIUM SIZE PROJECTS WHICH MOST AFFECTS THE CONSTRUCTION INDUSTRY. WE ARE AN INDUSTRY MADE UP OF HUNDREDS OF THOUSANDS OF SMALL FIRMS. PERFORMANCE OF SMALL AND MEDIUM SIZE PROJECTS BY PUBLIC AGENCIES FORECLOSES IMPORTANT GROWTH OPPORTUNITIES FOR EMERGING SMALL FIRMS, INCLUDING MANY MINORITY OWNED FIRMS. BECAUSE OF LOW OVERHEAD COSTS THESE SMALL FIRMS ARE VERY COST COMPETITIVE. CONSTRUCTION BY FORCE ACCOUNT OF THESE SMALL AND MEDIUM SIZE PROJECTS DENIES SMALL FIRMS THEIR RIGHTFUL PLACE IN THE MARKET.

IT IS WELL KNOWN THAT SMALL BUSINESS GENERATES THE MAJORITY OF NEW JOBS IN THE COUNTRY, AS WELL. THESE FIRMS OFFER EMPLOYMENT EXPERIENCE IN SKILLED TRADES WHICH EQUIP AN INDIVIDUAL WITH EXPERIENC THAT CAN PROVIDE AN EXCELLENT LIVING. IN CONSTRUCTION, MANY OF THESE SKILLED WORKERS EVENTUALLY BECOME CONTRACTORS THEMSELVES. THE EFFECT OF FORCE ACCOUNT CONSTRUCTION THEREFORE, IS TO FORECLOSE GROWTH OPPORTUNITIES FOR EXISTING BUSINESSES, DENY NEW FIRMS THE OPPORTUNITY FOR EXPANSION, DENY ENTRY EMPLOYMENT FOR MANY INDIVIDUALS AND TO PREVENT THOSE INDIVIDUALS FROM BECOMING SMALL BUSINESSMEN. THE IRONY OF HAVING A PUBLIC AGENCY PRODUCING THIS RESULT IS READILY APPARENT.

WE HOPE MEMBERS OF THE HOUSE AND SENATE WILL TAKE AN IMPORTANT STEP TO CORRECT MANY OF THE PROBLEMS WITH FORCE ACCOUNT CONSTRUCTION BY VOTING FOR S. J. RESOLUTION 93.

THANK YOU.

ATTACHMENT: TVA LETTER 3/6/81

TENNESSEE VALLEY AUTHORITY
KNOXVILLE, TENNESSEE 37902

[illegible] 6, 1981

Mr. Hubert Beatty
Executive Vice President
The Associated General Contractors of America
1957 E Street, NW
Washington, DC 20006

Dear Mr. Beatty:

Thank you for your February 3 letter asking about TVA's implementation of OMB Circular No. A-76. While we are in general agreement with the purposes underlying the circular, in many central requirements it is inappropriate to apply its detailed provisions to TVA's activities.

TVA's situation differs from that of other Federal agencies in several important respects. TVA's procurement authority for both appropriations and power-funded programs stems from Section 9(b) of the TVA Act and is independent from the large, Government-wide, procurement systems that apply to most other Federal agencies.

The TVA Act rests exclusive responsibility on the TVA Board for meeting TVA's overall statutory objectives as well as its specific obligations such as the Act's requirement that electric power be sold at rates that are "as low as are feasible" and TVA's binding covenant with holders of its bonds that its electric power operations will be conducted "in a sound and economical manner." This combination of responsibility and freedom to act specified by Congress has been the key to TVA's success throughout the years. To apply the detailed provisions of Circular No. A-76 to all of TVA's activities could substantially change this situation, since it would hamper the TVA Board's ability to operate TVA with the flexibility of a private business corporation as Congress intended. The inapplicability of this circular is recognized by the provision in the circular itself which states, "This Circular should not be applied when it would be contrary to law or inconsistent with the terms of any treaty or international agreement."

Contract versus force account comparative estimates are routinely prepared where past history or the situation indicates it may be more cost effective to contract work. In fiscal year 1980 alone, TVA spent $195 million on contracts for its construction program. We will continue to contract work where it is shown to be effective to do so.

An Equal Opportunity Employer

In response to your specific questions, TVA did not conduct any cost comparison analyses in calendar year 1980 which resulted in a decision to construct using in-house forces. We have not published any procedures for informal administrative review of our make-or-buy decisions, but we would be willing to meet with you or interested construction companies, as we have in the past, to discuss any questions you might have about our decisions on particular projects.

Sincerely,

W. F. Willis
General Manager

STATEMENT OF

DAVID L. GOLDENBERG, PRESIDENT

SILVER COIN-O-MATIC, DIV.
AMERICAN SALES, INC.

before the

SUBCOMMITTEE ON ADVOCACY AND THE
FUTURE OF SMALL BUSINESS
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

on

GOVERNMENT COMPETITION WITH SMALL BUSINESS

November 4, 1981

Statement of David Goldenberg

I am David Goldenberg, President of Silver Coin-O-Matic in Dayton, Ohio. I appreciate the opportunity to appear before you today in support of S.J. Res. 93.

During 1979 and 19[illegible] I served on the Small Business Administration Task Group on Government Competition. My experiences as a member of the Task Group were some of the most dramatic of my adult life. The more testimony we heard, the more I realized the perversion of Government Competition at all levels--but especially competition with small business. My reason was at first one of anger, but then fear--fear that the free enterprise system to which we all credit the strength of our Nation was in great jeopardy--not from revolution--not from erosion within the system--but from government--government whose purpose it is to protect the system.

I know you have heard other testimony on the activities of the Task Group, so I will not repeat the almost overwhelming number of cases which we examined. However, since serving as a member of the Task Group, I have continued to find examples of government competition with small business. I am Vice Chairman of the Independent Business Council of the Dayton Area Chamber of Commerce, and, since I was asked to testify before this Committee, I have been deluged by calls from many diverse businesses giving vivid illustration to the problem--a testing laboratory, a collection agency preempted from competing for government contracts because they were too small, a travel agency, and even a trophy shop complaining that the military base makes all of its own trophies.

The tremendous scope of this problem is of great concern to me as a citizen. It is also of great concern to me as a small businessman, and it is in my role as a small businessman that I am really here today.

Let me first describe my business, and then discuss why passage of S.J. Res. 93 is so important to my business and many small firms like mine in our industry. I will also propose one extension of the policy of the Resolution.

For the past twenty years, my company has provided laundry equipment in residential housing of all types in our market area. We purchase and install washers and dryers in common laundry facilities, collect the coins paid into the machines, and service the machines. We provide laundry machines in apartment buildings, condominiums, several colleges and universities, senior citizen and nursing homes, and Rickenbacker Air Force Base in Columbus. The machines are in many cases leased with services or, in exchange for the right to operate the laundry room, we provide the owner of the building or facility with a substantial proportion of the gross income we collect. We have a central office in Dayton, warehousing facilities, a service office in Columbia, eleven service, collection and sales vehicles, and employ fifteen persons.

The multi-family housing laundry industry that I am a part of has several hundred small firms like mine, operating mostly in metropolitan centers but also serving multi-family housing usually in communities within roughly a one hundred mile radius. Our industry was essentially created after World War II. With no federal assistance, the industry has managed to grow from a zero point to one which grosses and, in the main, pays taxes on $600 to $700 million of income per year. Our growth has occurred in the face of increasing problems of inflation, urban crime and vandalism, the difficulty of finding capable service and repair employees and significant and rising financing costs.

The future of our businesses may, however, in the long run be contingent on changing the Government's policy in using federal housing funds. I believe S.J. Res. 93 holds promise for doing this.

As you are no doubt aware, where federal agencies construct and operate housing projects themselves, they are prohibited by Office of Management and Budget Circular A-76 from purchasing laundry equipment without first doing a cost analysis. The purpose of this analysis is desirable—to determine whether it is ultimately cheaper for the Government agencies to provide laundry room service on their own than to contract with industry members. This order was developed after many years of study and preparation. In almost every instance, such a cost analysis concludes that the private sector can supply the necessary laundry service at lower costs.

The reach of OMB-A-76, however, is now of limited character. With the exception of military housing, governmentally-funded multi-family residence housing is largely in the hands of state and local housing authorities and such quasi-governmental entities as dormitory authorities. The Department of Housing and Urban Development presently permits state and municipal housing authorities to use federal grants to purchase laundry room equipment--washers and dryers--in public housing projects they operate. Not only does this procedure use federal monies to compete directly and unfairly with the private businesses of industry members, but the practice is almost invariably much more costly than contracting with members of the industry to supply and service that equipment.

Another practice detrimental to our industry is the Department's policy of allowing some public housing facilities to be planned, plumbed and wired so that each individual apartment in the project has its own washer and dryer in preference to any common laundry room facility. The New York City Housing Authority, for example, provides plumbing and wiring hook-ups for most of the apartments which it constructs. The added cost of this is $1,500 to $2,000 per apartment. Apart from the dollar costs, machines in individual apartments are used three to four times as much as fee charging machines in common laundry rooms, with substantial attendant consumption of scarce energy and water resources.

Mr. Chairman, I and the other small businessmen in our industry seek no federal subsidy, no handout, and no private sector monopoly on laundry room business in public housing facilities. Our simple request is only that no federal funds should be used to subsidize the purchase of multi-family residence laundry equipment or individual apartment facilities, either directly or indirectly, unless there is a demonstrated cost savings to the government. I support strongly the general concept of your resolution--that small private businesses should be free from unfair competition financed by their own tax dollars. This should particularly be so in those circumstances where that competition also increases the total cost of the federal housing program to the Nation while unnecessarily reducing the number of genuinely needy persons who can be served within the limits of a set federal housing appropriation.

Mr. Chairman, when the Task Group on which I served made its recommendation we recognized that OMB-A-76 needed a resolution such as S.J. Res. 93 in order to be effective. We also recognized the tremendous problem at state and local levels. For this reason, I ask that the salutary S.J. Res 93 be specifically extended to include state and municipal housing authority and other entities receiving federal housing funds.

Thank you again Mr. Chairman for the opportunity to present testimony before you today. I would be pleased to answer any questions the Committee has on this critical problem for my business.

Presentation of

Tom Crouser

On behalf of

NATIONAL ASSOCIATION OF QUICK PRINTERS

Before

THE UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS

Subcommittee on Advocacy and the Future of Small Business

November 4, 1981

For Information:

John F. Grant, Esq.

Harris, Beach, Wilcox,
Rubin and Levey
1730 M Street N.W.
Washington, D.C. 20036

Telephone: (202) 223-9250

My name is Tom Crouser. I am the president of Three Printers, a small printing company in Charleston, West Virginia. I am sppearing here today on behalf of the National Association of Quick Printers, an organization on whose board of directors I have served. Accompanying me today is our Washington counsel, John F. Grant, a member of the firm of Harris, Beach, Wilcox, Rubin and Levey.

The printing and publishing industry is one of the nation's largest. This year it will account for the production of approximately 60 billion dollars in manufactured items. Although it ranks within the top twenty industries in value added during manufacturing, it is characterized by an overwhelmingly small business population. The average sized firm in the industry has fewer than twenty employees. It has been called our nation's largest small business.

The National Association of Quick Printers represents nearly 3000 companies and establishments engaged in the printing industry. As such it is our industry's second largest trade association, yielding only to those who represent the largest of companies and those engaged in international business. It is on behalf of these members of NAQP that I address my remarks.

The members of NAQP are concerned with a continued encroachment of government competition from every level -- be it federal, state, or local. Our members have experienced unfair competition from governmentally financed agencies and institutions that are not subject to the same burdens of taxation and regulation to which our members must contend.

On a local level we have experienced competition from cities, counties, and other independent authorities, such as school districts. Virtually every state produces printing and other duplicating services that are in direct competition with those products and services upon which our members rely for their livelihood. In every instance our members are tax payers. Yet, through their taxes, they are being forced to support governmental actions which are in competition with them. Most unfairly, these governmental competitors are not subject to taxation, are very often relieved of compliance with governmental regulations and generally are allowed to price their products without regard to true market costs.

On the federal level, our national government maintains nearly 300 in-house government print shops. This is in addition to the facilities of the Government Printing Office operating here in Washington and the half dozen field printing plants run by the GPO in cities across the country.

I am sure that in the course of these hearings you will hear many witnesses mention the memorandum issued by the Office of Management and Budget, referred to as OMB Memorandum A76, which sets guidelines on the outside purchase of goods and services needed by the federal government. Significantly, printing does not come under the purview of Memorandum A76. Thus, it is that in recent years, federal agencies have been able to produce in-house what could more economically and efficiently be produced by tax paying commercial concerns under contract.

The production of government printing is not governed by the federal laws which apply to the procurement of all the other goods and services needed by the federal government. The Congress has determined that federal printing shall be under its control in accordance with Title 44 of the United States Code. Very generally, Title 44 states that all government printing shall be done in the Government Printing Office except in those instances where the Public Printer, the head of the Government Printing Office, determines that it shall be done elsewhere. This has meant that the Public Printer with the concurrence of the Joint Committee on Printing of the United States Congress has, through the years, approved the establishment of various agency printing plants and the production of government printing in them. That is the bad news. The good news is that the Public Printer with the concurrence of the Joint Committee on Printing has also approved contracting with commercial firms for the vast majority of printing under the authority of the GPO. In recent years this percentage has varied between 66 and 70 percent. Most of the printing of government publications, reports and documents is performed by commercial companies under contract.

It must be acknowledged that most recently the Joint Committee on Printing has taken significant steps to assess the desirability of continuing production in a number of agency print shops. They are assessing this need on the basis of efficiency and economy to the tax payer. This is a very salutary step and one very deserving of compliment. It is in the best interest of both the tax payers and of the need of the government to disseminate information.

Recently, the General Accounting Office, in response to a request by the Chairman of the Joint Committee on Printing, Senator Mathias, conducted a study entitled "Agency Printing Plants -- Choosing the Least Costly Option." The report identified approximately $234 Million worth of printing and duplicating which the GAO thought could be more economically procured from commercial firms, yet was being produced by agency printing plants at exceedingly high cost to the tax payer. It is to this amount of government competition to which our organization address itself.

The report also concluded that the government should explore possibiliti of expanding in-house copying and duplicating services. These are the items which the members of NAQP produce and which our members feel the government is conducting unfair competition.

We believe that we have developed a proposal which addresses both of the GAO concerns-- while accomplishing a number of other goals. It will allow a large number of small business concerns which are not now involved in government procurement to do so. It will allow the government to obtain its needs in the market place at a cost below that necessary to produce in-house. It will stem the further expansion of government printing, duplicating and copying services at a time when there is demonstrated capability in the private sector. It can be accomplished without the enactment of any new federal law and, finally, and most importantly, it does not require added expenditure of federal funds. In fact, it should save the government money.

Let me explain. At the present time, whenever the government has a need for short run printing or duplicating, it fulfills that need by having the material produced on fast production photocopying machines or small offset printing presses. Virtually every federal installation in every city of our nation has such equipment whether or not there is a demonstrated need for it and regardless of the availability of such services in the immediate commercial area. Large expensive photocopying machines and extra presses are maintained, over present requirements, so that whenever the government has a rush requirement the equipment is available.

Federal contracting procedures are such that even if an agency wished to use outside commercial services, the paper work and the delay in payment make it unattractive for the smallest of commercial concerns to engage in government business. We are all familiar with the voluminous boiler plate contained in every government contract. Once the work is performed, payment is often delayed from 60 to 90 days. Those who are not frightened off by the paper work are forced to finance the government inefficiency in delayed payment. The members of NAQP overwhelmingly operate on a cash and carry basis. They find the delay in government payment to be a feature which totally negates any attractiveness involved in doing government work. Yet, the taxes that they pay are used by the government to produce the copying and duplicating services which they could more economically perform.

We propose that whenever the government has a need for the printing, copying or duplicating of units which do not exceed 5,000 copies per unit, or 25,000 in the aggregate, which is required to be produced within 72 hours, that it survey by telephone small businesses which have indicated to specific agencies their willingness to produce such materials. Under this program, a local agency would be required to solicit on the telephone from local businesses prices for specific goods. The government would have to determine how many bids were necessary in order to preserve the competitive bidding process. When each bidder was told the requirements for a bid, a price would be solicited by the government procurement officer. In turn, each firm would be required to file immediately (most likely by post card) a statement indicating the job order number and the price bid. If a firm failed to file a written quote on a specific bid, it would be barred from participating in the program for a specified time. In this manner, the government would have evidence that competitive bids were solicited. When the required number of bids were solicited, the winning bidder would be informed by telephone of the award and asked to produce the material within the required time. After the work was produced. and delivered, the winning contractor would be given a voucher form, which he would present to the officer in charge of the petty cash fund, for immediate payment. At the present time, procurement regulations state that petty cash is available for a number of items, which generally are considered to encompass those needs which do not lend themselves to long range government planning. The figure available today is $150. We propose that that figure be increased to possibly $350.

In addition to the present allowable actions, we ask that copy and duplicating services returnable within 72 hours be added to those services enumerated for which petty cash funds may be spent. We ask also that the funds be available on a revolving basis. Internally, funds expended for this purpose would be charged against the agency's line item appropriation for printing and publication services.

Were this program to be initiated, the government would benefit because it would not have to make the investment in increased equipment and facilities in order to provide the growing need for copy and duplicating services cited in the GAO report. In addition, agencies would be able to increase their record of small business participation in contracting procedures. No new federal expenditures are necessary inasmuch as present existing capability within the industry is available to serve the federal need. Agencies, which now produce like material, at a lower cost than what they can procure commercially, would not be forced to go outside Other agencies with overload situations and those which, because of low level in-house requirements, pay a high rate for the production of such materials could take advantage of the availability of the commercial market.

We appreciate this opportunity to present our views and are willing to answer any questions which you may have.

Senator **Hayakawa**. I want to express my gratitute to all of you. Thank you very, very much for your testimony. We are going to continue with this work of gathering information and putting through the Senate Joint Resolution 93, to the greater prosperity of all of you, to the greater prosperity of the entire Nation, and to the support of the free enterprise system.

The meeting is adjourned.

[Whereupon, at 12:20, the subcommittee recessed, to reconvene at the call of the Chair.]

[Additional material follows:]

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

1957 E Street, N.W. • Washington, D.C. 20006 • (202) 393-2040 • TWX: 710-822-9406 AGC WSH

THOMAS E. DAILEY, *President* H. C. HELDENFELS, *Senior Vice President* RICHARD S. PEPPER, *Vice President*

E.W. McKENZIE, *Treasurer* HUBERT BEATTY, *Executive Vice President*

November 16, 1981

The Honorable S. I. Hayakawa
Chairman, Subcommittee on the Advocacy
and Future of Small Business
United States Senate
Washington, D. C. 20510

Dear Chairman Hayakawa:

The Associated General Contractors of America (AGC) was pleased to testify before the Subcommittee on the Advocacy and Future of Small Business on the topic of Government Competition with Small Business. We appreciate your efforts in reaffirming the basic policy of the government of the United States of reliance on the private free enterprise system for goods and services, as expressed in Senate Joint Resolution 93. We also support the Resolution's delegation of authority to the Office of Management and Budget (OMB) to administer the policy of Resolution 93.

We believe that a basic policy of noncompetition with the private sector and reliance on that system for goods and services should not be compromised by a distinction between federal and federally-assisted programs, as is the current policy of OMB in the application of Circular A-76. The taxpaying public expects public monies to be spent in the most economical and efficient manner possible, no matter what type of program these revenues fund. This is particularly important in public works construction where only $9 billion of annual expenditures are covered by OMB Circular A-76 out of total federal expenditures for public works construction of approximately $53 billion.

Although Resolution 93 does not make a distinction between federal and federally-assisted programs, we suggest that the resolution be amended to make clear that all federal funds used in public works construction are subject to the policy of Resolution 93. An

The Honorable S. I. Hayakawa
November 16, 1981
Page Two

amendment of this nature would provide a clear congressional direction to OMB to require that these funds not be spent on force account performance prior to the benefit of a cost comparison.

Again, thank you for the opportunity for AGC testimony on this important subject.

Sincerely,

Hubert Beatty

HUBERT BEATTY
Executive Vice President

S. I. HAYAKAWA
CALIFORNIA

PATTY WHITE
ADMINISTRATIVE ASSISTANT

United States Senate
WASHINGTON, D.C. 20510

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
FOREIGN RELATIONS
SMALL BUSINESS

November 23, 1981

Mr. Hubert Beatty
Executive Vice President
THE ASSOCIATED GENERAL CONTRACTORS
OF AMERICA
1957 E Street, N.W.
Washington, DC 20006

Dear Mr. Beatty:

Thank you for your letter of November 16 concerning S.J. Res. 93 and the wording included in it. I believe your suggestion for a possible amendment should be considered very carefully when the Resolution is considered by the Senate Committee on Governmental Affairs that has jurisdiction over it.

Since the Small Business Committee hearing records on this issue will be referred to the Governmental Affairs Committee, we will be sure to make your letter a part of the hearing record of November 4th.

Once again, thank you for arranging for Mr. David McCosker's appearance at the hearing. He was an excellent witness.

Sincerely,

S. I. Hayakawa

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

1957 E Street, N.W. • Washington, D.C. 20006 • (202) 393-2040 • TWX: 710-822-9406 AGC WSH

THOMAS E. DAILEY, *President* H. C. HELDENFELS, *Senior Vice President* RICHARD S. PEPPER, *Vice President*

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November 16, 1981

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Chairman, Subcommittee on the Advocacy
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United States Senate
Washington, D. C. 20510

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Although Resolution 93 does not make a distinction between federal and federally-assisted programs, we suggest that the resolution be amended to make clear that all federal funds used in public works construction are subject to the policy of Resolution 93. An

THE FULL SERVICE CONSTRUCTION ASSOCIATION FOR FULL SERVICE MEMBERS

amendment of this nature would provide a clear congressional direction to OMB to require that these funds not be spent on force account performance prior to the benefit of a cost comparison.

Again, thank you for the opportunity for AGC testimony on this important subject.

Sincerely,

Hubert Beatty

HUBERT BEATTY
Executive Vice President

INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS
1750 NEW YORK AVENUE, N.W., WASHINGTON, D.C. 20006
TELEPHONE NO. (202) 872-8484

John A. Gannon
President

Martin E. Pierce
Secretary-Treasurer

November 30, 1981

Senator S.I. Hayakawa
Select Committee on Small Business
424 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Hayakawa:

Enclosed please find our statement on Senate Joint Resolution 93, introduced by you on June 22, 1981, which we respectfully request be included in the public record of the Select Committee on Small Business to whom that resolution has been referred for consideration.

You will note that the IAFF objects to S.J. Res. 93 in its present form, since it does not provide for the exclusion from federal government contracting-out, functions such as fire protection and prevention and internal base security activities, which are crucial to the national defense. We turn your attention to the enclosed statement for our arguments in support of this position and for concrete examples of the inadequacy of private contractors for assuring the security of our military bases and installations.

We have, therefore, recommended the following language change in the resolution: In line 6, page 2, drop the period and replace it with

> ", with the exception of those functions that are essential and vital to maintaining and assuring the national security and the federal government's defense activities, such as fire protection and prevention functions and internal base security activities."

We urge you to support this amendment to S.J. Res. 93, and thank you for your cooperation and attention to this matter.

Respectfully,

Fred Schillreff

Fred Schillreff
Federal Staff
Representative

cc: Grace Hussie, Special Assistant to Senator Hayakawa

Affiliated with:
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS • CANADIAN LABOUR CONGRESS • NATIONAL FIRE PROTECTION ASSOCIATION

STATEMENT

on

S.J. RESOLUTION 93

to the

SELECT COMMITTEE ON SMALL BUSINESS

by the

INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS, AFL-CIO-CLC

This statement is to submit the views of the International Association of Fire Fighters (IAFF), AFL-CIO-CLC, representing approximately 175,000 federal, state and local fire fighters throughout the United States and Canada, on Senate Joint Resolution 93, which seeks to reaffirm that the basic policy of the United States government is to rely on the competitive private enterprise system, that is contracting-out, to provide needed goods and services.

The IAFF must object to S.J.Res. 93 in its present form, since it does not provide for the exclusion from federal government contracting-out, functions such as fire protection and prevention and internal base security, which are crucial to the national defense. Federal fire fighting activities, like all internal base security functions, are so completely integrated into the overall defense activities of federal bases and installations; that their contracting-out can only diminish military preparedness and national security.

The security of our nation's military bases and their defense activities is critically dependent on the employment of loyal, reliable and qualified fire fighting and base security personnel. The federal government can only assure that these personnel standards are met through the employment of federal civil servants.

The use of the federal civil service provides the government with a means for screening personnel so that they possess the necessary security clearances, and whose dedication to the nation's security and government is unquestioned. It also permits the federal government to maintain the work force continuity crucial to the understanding and successful implementation of base security procedures and regulations. Further, the use of civil service personnel allows the employing defense agencies to exercise overriding and direct control over base security personnel policies, practices and discipline, so crucial for the effectiveness of any defense functions. Its also permits defense agency requirements for the constant training and upgrading of fire fighting and base security personnel skills and capabilities.

None of the above criteria for maintaining a reliable and qualified fire fighting and base security work force can be met through the use of contract personnel. The use of such employees only jeopardizes the security of military base activities. Our experiences over the years provide numerous examples supporting this fact.

For instance, in using contractors, the military base commanders lose their direct control and discretion over fire fighting and base security personnel practices. Once a service is contracted-out, the contract is over-seen by the contract administration officer, who is either appointed by the procurement division that let the contract or by the base commander. The contract administration officer becomes the only contact between the federal government and the contractor, with the base commander losing control over base security functions and personnel.

The degree of federal government and defense agency control and discretion over base security personnel is further limited by the fact that, unlike federal civil servants, contract employees are covered under the National Labor Relations Act (NLRA), establishing their rights in the areas of collective bargaining, exclusive representation, and most importantly to the effective functioning of base security activities, the right to strike.

Past experience shows that contracted fire fighters and base security personnel can and do take advantage of their right to strike, to the detriment of military security. For example, soon after the Hunter's Point Naval Shipyard in San Francisco went from in-house to contractor fire fighters, the shipyard was struck and shutdown for two weeks. In recent years, at the Arnold Engineering and Development Center in Tullahoma, Tennessee, where fire fighting services have been contracted-out for some time, contract employees, who are members of the Metal Trades Department of the AFL-CIO, struck the facility.

More recently, the Oak Ridge Atomic Energy Development Plant just had a four to six week strike,and today the Army Early Warning Center in Nakota-Concrete, North Dakota, which watches for threats of invasion via the northern hemisphere, is in the process of negotiations which are not progressing and threaten to end in a strike.

One argument that has been used to support federal contracting-out of a variety of government services, is the cost-effectiveness of those practices. However, our experiences show that cost savings to the federal government for fire fighter services generally disappear within approximately two years of the contract, if not sooner. A factor which contributes to these increased costs is the collective bargaining rights of contract employees under the NLRA in conjunction with the prescribed pay practices under the Services Contract Act.

Under the Services Contract Act employees are required to receive pay comparable to wages being received in the surrounding area for the functions that are to be contracted-out. The Department of Labor is required, prior to contracting-out a function, to conduct an at variance wage determination and fringe benefit survey of the area to set comparable pay levels for contract employees. In the Presidio or on Treasure Island in the San Francisco area, for example, the comparable and prevailing wages for fire fighters is approximately $3000 higher than compensation received by the average federal fire fighter. Therefore, if those fire fighting services were to be contracted-out, under the pay comparability provisions of the Services Contract Act, fire fighter personnel costs in that area would necessarily increase, or services would have to be cut.

Furthermore, under the Services Contract Act any wage increases that a contractor and his employees may arrive at through collective bargaining and negotiations will be paid by the federal government and not the contractor, further increasing the costs of contracting-out such functions.

Finally, the availability and maitenance of a qualified fire fighter or base security work force is essential to the security of our military bases and installations. Our experiences with the contracting-out of fire fighting functions all over the country demonstrate that such a pool of qualified personnel is simply not available to private contractors.

This fact has been demonstrated both in the Nakota-Concrete facility in North Dakota, and in the army installation located in Hawthorne, Nevada to mention just two. In both cases, contractors who received the award for providing fire fighting services to those installations, were depending on hiring those federal fire fighters who were being displaced by contract emploees. Their expectations proved to be false in each instance, and in Hawthorne the displaced federal fire fighters rejected the contract employment to a man. This left the contractor with no ability to provide the required personnel and forced the Hawthorne installation to use federal fire fighters from other federal installations using TDY's, greatly increasing the costs of fire fighter services to that installation.

For all the above reasons, the IAFF is convinced that the security of our nation's military bases and installations, and therefore the national security, cannot be protected if contracters are permitted, and under the resolution, actually encouraged to take over those functions that are vital to the security of our military bases and installations.

We, therefore, recommend the following changes in the language of S.J.Res. 93: In line 6, page 2, drop the period and replace it with

", with the exception of those functions that are essential and vital to maintaining and assuring the national security and the federal government's defense activities, such a fire protection and prevention functions and internal base security activities."

E. B. CONN VENDING, INC.
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SUITE 200 - 8565 WEST DEMPSTER
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Now as near as your phone

November 2, 1981

DEAR SMALL BUSINESS LEADER:

When I was a delegate to the White House Conference two years ago, I had no idea that today I would be writing this letter asking for help because my business would be "under fire" by one of the bureaucracies.

The industry in which I am a part of is literally being forced out of business by the United States Postal Service. It is NOT the recent rate change I refer to. We've lived with those in the past and shall contiaue to live with them in the future -- if we're still in business.

The attached "report" will state our entire story.

We desperately need your help.

What I'm asking for is a nationwide letter writing campaign by small business owners. Today it is my industry, tomorrow it could be yours.

I ask that you please take some time to send off a letter to the White House and also to your Senators and Congressmen. I am enclosing four stickers for your use on the letters. These stickers were distributed by the Independent Business Association of Illinois (IBAIL) at our State Conference held last week in Springfield, Illinois. (I serve as Administrative Vice President for the group.) Our intent for the stickers is to get them used on correspondence to our legislators nationwide. We ARE a united group and it's time Washington realized we're all in this together.

If you are involved with a business association in your State, I'm asking that you please get a mailing to all the members asking them to write letters on our behalf. If necessary, our trade association will pick up the cost of printing and postage. We would even go so far as to do the mailing if you wish to send us the labels.

I close in saying as humbly as I can, that I have responded to Action over the last two years every time I received a plea from a fellow White House Conference delegate or a business group. I am hoping now that my efforts in positive action will pay off by my fellow business associates.

Thank you. I truly appreciate any efforts you make. I would appreciate copies of any correspondence.

Sincerely,

Eunice Conn
Eunice Conn

P. S. Stickers will be available for purchase at a later date. If you are interested, let me know and I'll forward prices. (please give me a few days--our current problem is like Wow!!!)

MEMBERS OF
CHICAGO ASSOCIATION OF COMMERCE AND INDUSTRY * NATIONAL ASSOCIATION OF POSTAGE STAMP VENDORS

November 2, 1981

Don and I own a second generation Small Business. We place and service privately owned vending machines that sell United States Postage Stamps in privately owned stores. The business is our livelihood.

When our industry came into being over 40 years ago, the public would pay 10¢ for three 3¢ stamps. As inflation came upon us, postage increased and gasoline prices rose sky high, as did our payroll, the mark-up on our vending purchase had to be increased.

Since our industry is one of public service, we felt the prices we were forced to charge the public, if we were to make a profit, were getting high. We came up with an idea.

Two years ago, we began serious negotiations with the United States Postal Service. Postmaster General William Bolger asked his Senior Assistant Francis Biglin and Assistant Gordon Morison to work with us.

We submitted a plan in the name of the National Association of Postage Stamp Vendors, of which my husband is a Past President, whereby we would test selling postage stamps at face value in private locations in Lake County, Illinois, which is just north of Chicago. The intent of this test was to gather all the necessary information that would be required to expand this program successfully throughout our existing network of postage vendors nationwide. Since our Company has been computerized for almost eight years, we are equipped to do so.

The plan seemed to be acceptable to all. Private enterprise could continue to provide a public service; the consumer could buy stamps at convenient locations at face value; the post office would be alleviated of selling the bulk of their stamps over the counter, thus cutting their costs.

The machines were to be bought by private enterprise; owned and operated by us. The only difference in our operation would be that the stamps would be sold at face value. Over the past two years, there were many trips back and forth to Washington, both by representatives from our National Association and representatives of the U.S. Postal Service.

The "snags" were ironed out, the Legal Department of the Post Office cleared the plan and contracts were drawn.

Then for reasons unknown to us, the plan was postponed several times. In June of this year, we were told the test plan was cancelled.

It wasn't until a few weeks ago that we realized why.

The Vending Division of the Postal Service came up with a plan to purchase vending equipment and proceeded to enter into competition with our industry. At least some of their equipment is being purchased, under contract, through Opal Manufacturing Co. in Canada. They are placing their vending equipment in privately owned stores and the private vendor is being told to pick up his machines.

Their plan is well underway and our entire industry is at stake. We were informed by an owner of a Drug Store Chain in San Francisco that the Post Office official seeking out locations in that area explained that the Postal Service is actively seeking locations in every high density area of the United States.

When we became aware of what was happening, we once again called Gordon Morison and indicated our grave concern. He told us to resubmit our plan for face value vending.

We did and in less than two weeks, on October 28, the answer came back unequivocally "no".

Aside from the obvious facts that hundreds of businesses within our industry will go bankrupt and our employees will be without jobs, we are faced with the fact that what the Postal Service is doing reaches further than home.

One more bureaucracy has chosen to compete unfairly with private enterprise at a high cost to the taxpayer.

The cost of the equipment the Postal Service is buying far exceeds the cost they would have paid if the machines they are using were manufactured by one of the existing Postage Stamp Machine Manufacturers that manufacture for private enterprise.

The cost of operation by the Postal Service is phenomenal in comparison to private enterprise. In Tulsa, Oklahoma, for example, there are five post office owned vending machines that are being serviced by two full time employees (salaries at $21,500 level) and one clerk spends half of her work week doing the clerical work on these sales. Our company has 4 lessees who work part time and one full time routeman who handle over 2,000 locations.

It is obvious that the Postal Service will not sign contracts with every small, family owned drug store or food store, as we do, thus adding to the problems these small businesses already have trying to compete with the chain food and drug stores.

If the Post Office were to succeed in getting their vending equipment in all the major cities, who will service the people in the rural areas -- or will it be necessary to add additional post office facilities per capita, such as is the case in England. (Currently, the private vendors service the big cities and the rural areas. If our major source of income, the major cities, is taken from us, we cannot continue to operate in scattered areas).

Some facts that are not known to the public is that we do, in fact, save the taxpayers millions of dollars each year. Based on figures of Postmaster Blount in the 1960's, the vending machine operators in the Chicago area alone saved taxpayers in excess of $16,800 each week due to the volume purchase vendors make at the post office versus what the Post Office would have to pay additional personnel to handle those same purchases if they were made over the counter. We do not have the 1980 figures, but add 20 years of inflation to the above and the sum is enormous.

In closing I'd like to add that one vendor in Texas is already under "heavy fire". The postal service has contracted with 200 of his locations which do in excess of $200,000 sales a year. At a time when we must increase our number of locations just to keep up with inflation, this man is spending his working hours removing machines so the Postal Service can "move in".

We are sure you can sense the urgency in this matter. We thank you.

DONALD CONN
EUNICE CONN
E. B. CONN VENDING, INC.
8565 W. Dempster/Ste. 200
Niles, IL. 60648

312/692-5733

APPENDIX

ASSOCIATION OFFICERS
JESSE M. PIKE, PRESIDENT
136 BEVERLY DRIVE NE CONCORD NC 28025
NEIL L. PRUITT, PRESIDENT-ELECT
105 W DOYLE ST TOCCOA GA 30577
CHARLES M. WEST, FIRST VICE PRESIDENT
1020 PLAZA WEST BLDG LITTLE ROCK AR 72205
DON B. KATTERMAN, SECOND VICE PRESIDENT
5400 SAND POINT WAY NE SEATTLE WA 98105
RALPH P. GUERRA, JR., THIRD VICE PRESIDENT
2150 E JUDGE PEREZ DRIVE CHALMETTE LA 70043
JOSEPH A. MOSSO, FOURTH VICE PRESIDENT
419 CAROLYN AVENUE LATROBE PA 15650
WILLIAM S. KATZ, FIFTH VICE PRESIDENT
28 STAGE COACH LANE NEWINGTON CT 06111
DONALD W. ARTHUR, SECRETARY TREASURER
431 TONAWANDA ST BUFFALO NY 14207

EXECUTIVE COMMITTEE
JOHN A. JOHNSON, CHAIRMAN
101 EAST MISSION ST BELLEVUE NE 68005
JAMES H. VINCENT
315 EAST 8TH AVE YUMA CO 80759
JOHN W. WHITE
1736 THOMASVILLE RD TALLAHASSEE FL 32303
H. JOSEPH SCHUTTE
3309 COLLEGE DRIVE LOUISVILLE KY 40299
LONNIE F. HOLLINGSWORTH
5119 34TH ST LUBBOCK TX 79410
D. J. WILLIAMS
611 2ND ST WEBSTER CITY IA 50595

THE NATIONAL ASSOCIATION OF RETAIL DRUGGISTS
EXECUTIVE VICE PRESIDENT • WILLIAM E. WOODS
1750 "K" STREET N.W. WASHINGTON, D.C. 20006
AC 202 347-7495

June 22, 1981

The Honorable S.I. Hayakawa
U.S. Senate
6217 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Hayakawa:

The National Association of Retail Druggists represents the owners of more than 30,000 pharmacies where 75,000 pharmacists practice their profession. These pharmacies fill approximately 70% of all prescriptions and serve 18 million consumers daily.

Our members, who with other small businesses are the backbone of the economy providing 90% of all new jobs, are concerned about competition in health care. In particular, competition with government!

One example of government competition with the independent retail druggist is the Veterans Administration. The VA has a prescription drug program for veterans. The veterans must go to a VA facility or use the mail for prescription drugs. One of NARD's priorities for the 97th Congress is to see legislation enacted which would assure that veterans are provided the quality of pharmaceutical services to which they are entitled, rather than the present VA program which relegates our veterans to third class citizenship.

NARD supports the following priorities in VA Drug Program legisation:

1. Any veteran who is not a patient in a VA facility has a choice of the source of needed pharmaceutical services.

2. No longer will those who so ably served our country be forced to go to a VA facility or use the mail for prescription drugs.
3. No longer, as studies by the Disabled American Veterans have shown, will veterans have to wait more than four hours for a prescription to be filled, resulting in a loss of an entire day, when travel time is included.
4. No longer will the veterans who either cannot afford to, or are otherwise unable to travel to distant VA facilities, be forced to use the mails. Studies have documented that veterans are sent the wrong prescriptions, with incorrect or inaccurate instructions, experience -- as we all know -- excessive delays, are sent prescriptions that are no longer being approved by the physician.

Another area of government competition with small retail pharmacy owners is in the area of federally-funded Health Maintenance Organizations (HMO's). Independent retail pharmacists have a number of tough competitors -- chains, mass merchandisers, other independents for starters. The Federal Government, however, is the toughest and most unfair of all competitors.

Federally-funded HMO's are competing with the independent pharmacist in many areas. They are involved in forcing these small businesses into bankruptcy with policies which deny patients the freedom to choose their provider of pharmaceutical services. The competition from HMO's, with federal subsidies, is getting worse.

NARD does not necessarily disagree with the HMO concept, but NARD steadfastly objects to federal policy or laws that deny HMO subscribers the dignity of freedom of choice. NARD also opposes regulations which allow HMO's to provide services to non-HMO subscribers, particularly in view of the HMO's drug purchases at discriminatory prices.

Whether it be the Veterans Administration drug program, HMO's, mental health, family planning or a myriad of other areas, it seems that every time our members turn around the Federal government has funded another high overhead, inefficient program to compete with them. Just as home ownership appears to be on the wane, such policies are eroding another component of the American Dream: owning your own business.

It is our purpose to commend you for scheduling the series of hearings on the subject of Government Competition with Small Business to begin this week. We feel confident that these hearings will provide the forum needed to expose this grave problem to the Congress and the public, and lay the groundwork for worthwhile progress towards finding a solution to government competition with small business.

NARD is pleased to accept your gracious offer to testify at one of the later hearings and looks forward to working with you and the Subcommittee on Advocacy and the Future of Small Business staff as the hearings progress. Kim Elliot and Grace Hussie of the Subcommittee staff and Anne Sullivan of the full Committee staff have been most helpful and efficient in providing preliminary information. If we can be of any assistance to you or the staff, please do not hesitate to contact us.

As a prelude to our later testimony, I would like to request that this letter appear in the record statement of the opening hearing, June 24th.

The Officers and Executive Committee, as well as the NARD staff, stand ready to assist the Small Business Committee in providing whatever additional assistance we can to ensure the growth of Small Business in the 80's.

Sincerely yours,

William E. Woods

William E. Woods
Executive Vice President

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